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Abstract

This article focuses on the relevant taxation aspects of Taiwan's ambition to become an Asia Pacific Regional Operations Centre (or "APROC"). This article establishes that the current taxation regime is outdated and inadequate when compared to Taiwan's closest rivals in the region, namely Hong Kong and Singapore. In order for Taiwan to become a leading operations centre, the Taiwanese Government will need to speed up its taxation reform process and make Taiwan more competitive in attracting multinational companies into the country.

Keywords

Taiwan, tax, APROC

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Candidate, Doctor of Legal Science (Bond University). The author would like to thank Professors Ross Buckley and Duncan Bentley for their comments. This article does not represent any opinion of Coopers and Lybrand (Taiwan) or any member firms of Coopers & Lybrand (International).

DEVELOPING TAIWAN INTO A REGIONAL FINANCE AND OPERATIONS CENTRE: A TAXATION PERSPECTIVE



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This article focuses on the relevant taxation aspects of Taiwan's ambition to become an Asia Pacific Regional Operations Centre (or "APROC"). This article establishes that the current taxation regime is outdated and inadequate when compared to Taiwan's closest rivals in the region, namely Hong Kong and Singapore. In order for Taiwan to become a leading operations centre, the Taiwanese Government will need to speed up its taxation reform process and make Taiwan more competitive in attracting multinational companies into the country.

INTRODUCTION

Although some commentators argue that taxation is not a decisive factor in foreign investment decisions,¹ a favourable tax policy and/or fiscal incentives do play a role in attracting investment, with fierce competition between major investment host nations. While the experiences of each country may differ, a taxation regime can exert considerable influence on the size and location of investments and other business decisions made at the margin.² Tax related

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¹ Other factors may include political stability, capital and foreign controls, government's industrial policies, industrial relations in hosting nations, size of markets, and so on. See Sasseville J, "Current Issues in International Tax Policy" in Vann R (ed), *Tax Treaties: Linkages Between OECD Member Countries and Dynamic Non Member Economies* (1996) 12.

² Wilkins J, "The Impact of the United States Tax Reform on Inward and Outward Capital Flows" in OECD (ed), *Taxation and International Capital Flows: A Symposium of OECD and Non-OECD Countries June 1990* (1990) 33.

issues are also likely to affect the manner in which the investment is financed and the form in which profits are repatriated.³ Governments around the world generally believe that tax systems must be responsive to developments in other countries or risk losing investment capital to those countries with a more favourable tax system.⁴ This explains the widespread use of fiscal incentives throughout the world to attract "international hot money."⁵ Meanwhile, many countries in the Organisation for Economic Cooperation and Development ("OECD") have commenced a series of tax reform programs since the late 1980s with the aim of making their taxation systems more equitable and competitive.⁶ The fact that governments have mimicked each other regarding the timing and content of tax reforms suggests that policy makers believe taxes play an important role in the competition for investment dollars.⁷ Furthermore, with increasing internationalisation of economies and greater capital mobility, countries have also become more fiscally interdependent. While the influence of monetary policy on capital movements diminishes, tax parameters have emerged as one of the few remaining instruments available to government to influence these flows.⁸ Empirical research suggests that if capital is mobile, even a modest increase in the taxation of capital should have a significant long-run impact on the balance of capital stock.⁹

³ Shepherd C, "The Experience of the United Kingdom" in OECD (ed), *ibid* at 105.

⁴ Anderson P, "Overview and Summary of Discussions on Tax Reform" in OECD (ed), *above n 2* at 28.

⁵ The Secretary-General of OECD, "Opening Address by the Secretary-General of OECD" in OECD (ed), *above n 2* at 12-13. Issues of fiscal and taxation incentives are discussed in a later section of this article.

⁶ These reforms include:

- (i) reduction of corporate income tax rates;
- (ii) reduce the level of tax incentives;
- (iii) introduction of imputation taxation system;
- (iv) introduction of value-added taxes (or goods and services taxes).

See generally OECD (ed), *above n 2*.

⁷ *Above n 2* at 33.

⁸ Fernandez-Perez J, "Investment Flows into Non-Member Countries" in OECD (ed), *above n 2* at 47.

⁹ Grubert and Mutti (1987), *above n 2* at 35. Taxes also exert significant influences on international debt finance and transactions. See generally Scott HS and Wellons PA, *International Finance – Transactions, Policy and Regulation* (1995) 686-693.

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In January 1995, the Taiwanese government launched its “cross-century” economic plan, with the aim of building Taiwan¹⁰ into an Asia Pacific Regional Operations Centre (“APROC”). Under the proposal, it plans to attract local and foreign enterprises to make Taiwan their operational base for investment and business activities in the region, including Southeast Asia and China. Under a thorough evaluation conducted by the government, it has been confirmed that Taiwan enjoys substantial potential in developing itself into a center for manufacturing, transportation, financial, telecommunications and media activities.¹¹ Among these “sub-centres,” the plan to transform Taiwan into a regional financial centre has attracted the most attention: in part, this interest has been linked with recent trends in Taiwan’s financial landscape, characterised by the government’s efforts to achieve greater deregulation and internationalisation.¹²

However, the current taxation regime in Taiwan is outdated and inadequate when compared to OECD countries or other countries in the Asia Pacific region. For example, while the Trust Law was enacted in 1996 to provide for a general vehicle for asset management, Taiwan has yet to develop the commensurate tax legislation or rulings applicable to trusts.¹³ The current taxation rules are also not in accordance with tax practices that have been generally adopted in major financial centres around the world. For Taiwan to develop into a regional finance and operations centre, the authorities in Taiwan will need to remove disincentives in the current tax system and reform current practices to an internationally accepted standard. The authorities might also consider following the lead of other countries in the region, by introducing a comprehensive incentive package to induce multinational companies (“MNCs”) to establish their APROCs in Taiwan. This article discusses these issues and provides recommendations.

¹⁰ “Taiwan”, “The Republic of China” and “ROC” will be used interchangeably. For current issues on Taiwan’s political and economic backgrounds see generally Godwin A, “Legal Aspects of Australia’s Commercial Relationship with Taiwan” (1992) 4 Bond LR 41-72 and Semkow BW, *Taiwan’s Financial Markets and Institutions: The Legal and Financial Issues of Deregulation and Internationalization* (1992).

¹¹ See generally The Council for Economic Planning and Development, *The Plan to Develop Taiwan into an Asia Pacific Regional Operations Centre* (1995).

¹² See generally Liu LS, “Creating an International Financial Center: The Case of Taiwan, ROC” in Norton JJ, Cheng CJ and Fletcher I (eds), *International Banking Operations and Practices: Current Developments* (1994). See also Watanabe RN, “Foreign Exchange and Capital Movement Controls in Taiwan” (1998) 16(5) *UCLA Pacific Basin Law Journal*, forthcoming.

¹³ Liu LS, “The Law and Political Economy of Capital Market Regulation in the Republic of China on Taiwan” 28 *Law & Policy in International Business*, forthcoming.

A BRIEF INTRODUCTION TO TAIWAN'S CURRENT TAX LAWS

Under the Income Tax Law,¹⁴ the income tax regime in Taiwan is divided into consolidated personal income tax for individuals ("individual tax"), and profit-seeking enterprise income tax for business enterprises ("business enterprises tax").¹⁵ The term "business enterprises" refers to any entity which engages in business activities or profit-seeking purposes. In other words, sole proprietorships, partnerships, companies or any other form of organisation are subject to the business enterprises tax.¹⁶ Sole proprietorships and partnerships are regarded as separate legal entities in Taiwan for taxation purposes, the opposite of the "flow-through" system which operates in Australia and the US.¹⁷ Individuals, irrespective of whether they are resident¹⁸ in Taiwan, are subject to income tax on Taiwan sourced income only.¹⁹ The residence status merely determines how an individual will be taxed on Taiwan source income: a resident individual is subject to the marginal rates,²⁰ with entitlement to personal exemptions and deductions, while non-residents are generally subject to the withholding tax on gross income without any personal exemptions or deductions allowed.²¹

¹⁴ Promulgated in 1943 as amended to December 1989.

¹⁵ Income Tax Law Art 1.

¹⁶ Income Tax Law Art 11. However, a professional partnership consisting of lawyers, accountants, medical doctors, architects, engineers or other professionals is not considered a separate tax entity. The individual partners are taxed, similar to the system adopted in Australia.

¹⁷ The taxable income of a sole proprietorship or a partnership is first subject to business enterprise tax, and the sole proprietor or the partners are then liable for individual income tax on their shares of the remaining income. However, double taxation will be eliminated under the newly proposed imputation system (see the following section).

¹⁸ Taxpayers who have a domicile and regularly live in Taiwan will be classified as residents for taxation purposes. Individuals who are not domiciled in Taiwan but live in Taiwan for more than 183 days during the financial year will also be considered as residents for tax purposes. Income Tax Law Art 7.

¹⁹ Income Tax Law Art 2.

²⁰ The rate of individual income tax on taxable income, which are applied after deducting personal exemptions, allowances for dependents, and other deductions, are as follows:

Taxable Income (NT\$)	Tax on Lower Rate (NT\$)	Marginal Rate (%)
0 to 300,000	0	6
300,000 to 800,000	18,000	13
800,000 to 1,600,000	83,000	21
1,600,000 to 3,000,000	251,000	30
3,000,000 above	671,000	40

Source: Coopers & Lybrand, 1997 *International Tax Summaries* T-2.

²¹ Income Tax Law Art 2.

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A “resident company” (and a business enterprise) in Taiwan is subject to income tax on its worldwide income.²² A company (or a business enterprise) is deemed to be a resident for tax purposes if it is incorporated or established under Taiwan’s Company Law or other relevant laws, regardless of whether they are owned by foreign investors or local investors, or jointly by both.²³ Therefore, foreign subsidiaries, or holding companies of MNCs incorporated in Taiwan, will be classified as residents for tax purposes. On the other hand, a “resident foreign company” generally refers to a company incorporated under a foreign jurisdiction, which has a “fixed place of business” or “business agent” in Taiwan.²⁴ Similarly, resident foreign companies are subject to income tax at the same rates as Taiwan resident companies.²⁵ Non-resident foreign companies, similar to non-resident individuals, are subject to a final withholding tax on the gross amount of their Taiwan source income.²⁶ The new imputation credit system was proposed by the government in early 1997. However, awaits the final approval by the Legislative Yuan.²⁷

A taxpayer, whether resident or non-resident, individual or company, is subject to withholding tax at source by the payers of salaries,²⁸ dividends and interest,²⁹ rentals, royalties and other income.³⁰ Since 1 January 1990, no capital gains tax has been levied on income derived from securities trading.³¹ However, to retain such income as a revenue source, and as a means of controlling trading volumes on the secondary market, a securities transaction tax was introduced on shares traded on the Taiwan Stock Exchange and the

²² Income Tax Law Art 3.

²³ Huang JTT, “Income Taxation” in Silk MA (ed), *Taiwan Trade and Investment Law* (1994) 484.

²⁴ Ibid.

²⁵ Above n 20 at T-1.

²⁶ Income Tax Law Art 41.

²⁷ Details of the classical system and the proposed imputation system are discussed in the following section.

²⁸ Similar to the “pay-as-you-earn” (PAYE) system in Australia.

²⁹ All dividend payments are subject to withholding tax. Residents must include dividends received in their gross income, but the tax withheld may be credited against their liability. The exemption from income tax may be applied if the amount received is under a certain threshold level. Interest income is taxable subject to a 10% withholding tax for resident beneficiaries and 20% for non-resident beneficiaries. Share and cash dividends from TSE listed companies and interest income, except on postal savings accounts and short-term commercial papers, are subject to an exemption of up to NT\$270,000 (approximately A\$13,500) when included in the individual taxpayers’ consolidated income tax.

³⁰ See generally Horwath International, “Taiwan” in *International Tax Planning Manual* (1993).

³¹ Chuang and Sterling, “Taiwan’s Securities Industry” noted in Semkow, above n 10 at 186. This exemption applies to both the listed securities as well as unlisted publicly issued securities.

Over-the-Counter market.³²

TAIWAN'S "APROC" MODEL AND RELATED TAXATION REGIME

Among many "operations centre" models available around the world,³³ Taiwan's APROC model is similar to Singapore's operational headquarters ("OHQ") model, which is a hybrid version of the holding company and pure regional headquarters models. In addition to the Singaporean model, Taiwan also allows APROC to perform "treasury centre"³⁴ functions as part of Taiwan's ambition to become a regional financial centre. It appears that Taiwan's APROC model includes the best features of the available models to facilitate a wide range of operational, financial and investment functions for companies of the same group in the region.

One of the objectives for an APROC is to act as an intermediate holding company between the parent company in the home country and the affiliated entities operating in one or more other jurisdictions in the region. The operation of a holding company or operations centre is underpinned by the following taxation objectives:³⁵

- 1 defer the payment of taxes which would otherwise be levied upon the top holding company. The dividends received by the intermediate holding company can be retained, so that they themselves increase with the interest on the taxes on which payment has been postponed;³⁶
- 2 similar to 1, retain dividends obtained from operating companies, not to earn interest, but to await the decision on the most useful and

³² Ibid.

³³ The following models are currently used around the world and can be summarised as:

- (i) the holding company model,
- (ii) a pure regional headquarters model,
- (iii) a treasury centres model,
- (iv) holding company and pure regional headquarters hybrid model, and
- (v) treasury centre and pure regional headquarters hybrid model.

See generally Price Waterhouse, *Attracting Regional Headquarters to Australia – A Suggested Model* (1993).

³⁴ Some of the "treasury centre" regimes include Ireland's "international finance centre" and Singapore's "finance and treasury centre" schemes.

³⁵ Scarlata FG, *Global Tax Planning* (1995) 91-92.

³⁶ Normally, the holding company will be located in a country which exempts tax on dividends providing they originate abroad. However, such a practice might be scrutinised if operating in a tax haven jurisdiction, or where the Controlled Foreign Companies legislation applies. Implications of these regulations will be discussed in the later section of this article.

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functional redistribution of wealth to the various entities of the group;

- 3 an intermediate holding company can be used as an operational vehicle to practise “treaty-shopping” techniques;³⁷
- 4 aim to sell shares in controlled companies located abroad without subjecting the top holding company to a capital gains tax liability;³⁸
- 5 aim to assemble in a single jurisdiction (that of the intermediate holding company) different tax credits, which, if received by the top holding company, would be subject to separate accounting for each foreign dividend source. Indeed, if received by the top holding company, some of these credits might be lost due to the lack of relevant tax charges or the absence of compensation rules;³⁹
- 6 aim to avoid exchange controls and enjoy confidentiality in the case of international mergers and acquisitions, or in the case of a redistribution of financial flows within the entities of the group;⁴⁰ and
- 7 aim to rationalise management problems according to the geographic distribution of the operating companies, or on the basis of their trade homogeneity, or other factors.

Similarly, by forming an offshore treasury centre, if planned properly, an MNC could effectively reduce potential tax liability. Some of the main tax reasons for forming an overseas finance company include:

- (i) diverting profits out of the jurisdiction of the parent company;
- (ii) extracting profits from overseas jurisdictions with relatively high rates of tax; and

³⁷ “Treaty shopping” designates the use (not abuse) of treaty protection by interposing a person who can claim such treaty protection which would not have been available otherwise. Normally, there is a triangular situation, eg, the relationship of a company in country A to a company in country B through an interposed company in country C, eg, because there is a treaty between B and C and no treaty between A and C. See Kuiper WG, Butzelaar F, Comello WA, and Jap KS (eds), *International Tax Glossary* (1988) 276-277.

³⁸ The intermediate holding company, in such cases, will already be located in a country where that capital gains tax does not exist. For example, capital gains arising from the sale or exchange of private assets are exempt and rates are reduced for other assets in the Netherlands. In other popular holding company destinations such as Singapore (and Taiwan) and the tax haven countries, there is usually no capital gains tax.

³⁹ Issues of taxation on foreign source income and the foreign tax credit system will be discussed later.

⁴⁰ For example, there are no foreign exchange controls in the BENELUX countries (which include Belgium, the Netherlands and Luxembourg) and in Hong Kong.

(iii) a combination of (i) and (ii).

The taxation regimes in countries such as the Netherlands, Switzerland and Singapore, when combined with operations in tax-havens, provide the essential elements for structuring international financing activities.⁴¹ They provide access to extended networks of double tax agreements, which reduce or eliminate withholding taxes on passive income. The absence of withholding tax on payments of such income allows the company's profits to be moved to a low tax or tax haven jurisdiction through intermediate countries without attracting significant tax liability.⁴²

To achieve such an outcome, a suitable jurisdiction for MNCs' holding companies and treasury centres will generally possess the following taxation characteristics:⁴³

- 1 the existence of low or concessionary income tax rates for qualified operations;
- 2 the existence of a large number of double taxation agreements which exclude withholding taxes on dividends, interest and royalties;
- 3 an exemption from withholding taxes on payments of interest and dividends made by the holding company itself to third parties or to its shareholders;
- 4 an exemption from income taxes for all proceeds originating abroad, including capital gains; and
- 5 the existence of a "deemed income" taxation method.

MNCs would not find Taiwan an attractive destination to establish holding companies or operations centres because of various disincentives still in existence. These include high effective rates of income and withholding tax and the lack of an extensive treaty network and incentive package for MNCs. Until these disincentives are removed, it will be difficult for Taiwan to compete against its rivals in the region such as Hong Kong, Singapore and Malaysia.

INCOME TAX RATES

Often international capital is attracted to low tax countries (usually classified as tax havens). Significant differences in tax rates may become disincentives

⁴¹ Ogley A, *The Principles of International Tax* (1994) 110.

⁴² Ibid.

⁴³ Ibid at 109-110. See also Scarlata, above n 35 at 82, and above n 33.

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to inward investment, since they reduce profits and affect the rate of return, including cash flow. Frequently, high tax rates may induce MNCs to:

- (i) relocate profitable operations out of the jurisdiction applying higher tax rates into a low-tax jurisdiction;
- (ii) shift taxable income through transfer pricing practices;
- (iii) change the financial structure of business from equity to debt; and
- (iv) locate expenses and interest deductions in high tax countries.⁴⁴

Accordingly, differences in tax rates could result in a loss of tax revenues by countries maintaining high tax rates.⁴⁵ While not all international financial centres have low tax rates, those which do have low tax rates (eg, New York and Tokyo) are large and their activities are generally a function of the pool of domestic savings they offer.⁴⁶ For smaller centres, low tax rates are an essential part of the overall environment they offer market participants.⁴⁷

Taiwan's current rate of company income tax is 15% on income up to NT\$100,000⁴⁸ and 25% on income over NT\$100,000.⁴⁹ In comparing these "nominal" rates with those of other regional centres, Taiwan does offer a competitive rate to business entities, as Table 1 illustrates:

Table 1
Nominal corporate tax rates in regional financial centres⁵⁰

Major financial centres in the Asia Pacific region	Nominal corporate tax rate (%)
Taipei, Taiwan	25.0
Tokyo, Japan	37.5 ⁵¹
Singapore	26.0
Hong Kong	17.5
Sydney, Australia	36.0
Kuala Lumpur, Malaysia	30.0

An OECD survey revealed that "effective" corporate tax rates and/or withholding tax rates have been identified as significant obstacles to cross

⁴⁴ Above n 2 at 34. See also Fernandez-Perez, above n 8 at 47.

⁴⁵ Fernandez-Perez, above n 8.

⁴⁶ Savage J, *Financial Centre Prospects for New Zealand* (1988) 51.

⁴⁷ Ibid.

⁴⁸ Approximately A\$5,000, which also includes other profit seeking enterprises.

⁴⁹ Above n 20 at T-1.

⁵⁰ Source: *ibid.*

⁵¹ This is the highest marginal company tax rate. Above n 20 at J/9.

border investment in the Asian “newly industrialised countries.”⁵² Effective tax rates in some of these countries are, in fact, substantially higher than the legislated nominal rates because of statutory and regulatory restrictions with respect to the allowability of certain deductions in determining the tax base. For example, transfer of losses within a group of companies is not recognised in Taiwan;⁵³ and the maximum deductible amount for bad debt losses is strictly limited to 1% of the year-end outstanding accounts or notes receivable.⁵⁴ As similar deduction items are available in other regional jurisdictions, it appears that Taiwan’s effective tax rate could be higher than those of its rivals.

As mentioned, Taiwan still operates on the basis of a “classical” taxation system with regard to company profit and dividend distribution. Tax is imposed at a corporate level while shareholders, upon receipt of after-tax distributions, are again subject to tax. In other words, the underlying profit is double taxed at the corporate and shareholder level, the result being a high effective tax rate (see Table 2).

⁵² Hammer R, “Tax Obstacles to Investment in the Dynamic Asian Economies” in OECD (ed) *Taxation and Investment Flows – An Exchange of Experiences between the OECD and the Dynamic Asian Economies* (1994) 120.

⁵³ Taiwan does not recognise the tax consolidation concept, so profits and losses cannot be offset within a group of companies in Taiwan. Above n 30 at 86331.

⁵⁴ Income Tax Law Art 49. Deductions based on the provision method are allowed for estimated bad debt losses on accounts and notes receivable. However, the provision may not exceed 1% of the year-end outstanding accounts and notes receivables. Such a practice is different from the approach adopted in Australia, Singapore and Malaysia where the full amount can be claimed if the amount is actually written off during the year. (Australian) Income Tax Assessment Act 1936 (Cth) s 63 (“ITAA”); see also above n 20 at S/45 and M/27. Bad debts and doubtful debts are fully deductible in Hong Kong. Ibid at H/9. The current Taiwanese approach might encourage taxpayers to claim the maximum statutory allowance each year, even though no actual bad debt is written off during the year. Meanwhile, if the actual written off amount is greater than the 1% ceiling, the taxpayer will have to bear such losses without any taxation or fiscal relief. Interestingly, a similar “percentage” system, ie, deductions of a certain percentage of doubtful debts provisions, also operates in Japan. Ibid at J/19.

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Table 2
Effective tax rates in Taiwan⁵⁵

	Individual resident shareholders	Corporate resident shareholders	All non-resident shareholders
Taxable income	\$ 100.00	\$ 100.00	\$ 100.00
Less: corporate income tax payable ⁵⁶	<u>(25.00)</u>	<u>(25.00)</u>	<u>(25.00)</u>
Earnings available for appropriation	75.00	75.00	75.00
Shareholders' income tax	<u>(30.00)</u> ⁵⁷	<u>(18.75)</u> ⁵⁸	<u>(15.00)</u> ⁵⁹
Net income received	<u>45.00</u>	<u>56.25</u>	<u>60.00</u>
Total tax paid (and the effective tax rate)	<u>55.00</u>	<u>43.75</u>	<u>40.00</u>

As shown in Table 2, both local and foreign investors in Taiwan must bear a relatively high tax burden due to double taxation on the company and shareholders. The only solution to "double taxation" is to replace the current system with an imputation system, which is already in operation in some of the countries in the region, including Singapore,⁶⁰ Malaysia⁶¹ and Australia.⁶² With an "imputation" system, the payment of company tax is imputed to the shareholder.⁶³ In other words, shareholders who receive assessable dividends from a company, are entitled to a credit for the tax paid by the company on its income.⁶⁴ From a shareholder perspective, this means that dividends are assessed at the shareholder's top marginal rate, thereby eliminating the problem of double taxation on corporate profits. Reports indicate that the authorities in Taiwan are working on a major project to amend the current Income Tax Law, including a proposal to introduce the imputation tax system. Some aspects of the proposed imputation system have been controversial, costing months of long discussions between the private sector and the

⁵⁵ Assumptions made include:

- (i) all earnings are appropriated in the same year; and
- (ii) all entities receive no tax related incentives during the year.

⁵⁶ Assuming the nominal tax rate is 25% and calculated on flat basis.

⁵⁷ Calculated at 40%, the highest marginal individual rate.

⁵⁸ Calculated at 25%, the rate for profit seeking enterprises.

⁵⁹ Calculated at 20%, the non-resident withholding tax rate.

⁶⁰ Marks B, "Taxation and Foreign Investment in the Six DAEs Countries: A Summary Background Paper" in OECD ("Dynamic Asian Economies"), Hammer, above n 52 at 63.

⁶¹ Ibid at 58.

⁶² See generally CCH, 1997 *Australian Master Tax Guide* paras 3-600 to 3-800.

⁶³ Marks, above n 60 at 87.

⁶⁴ Ibid.

government.⁶⁵ However, the move to an imputation system should be perceived as a positive step toward a fairer and more equitable tax system.

To reduce the effective tax rate and attract more MNCs to establish their operations centres in Taiwan, the authorities will need to examine the possibility of introducing a comprehensive tax incentive package. For example, Singapore has introduced tax incentives for holding companies or operational headquarters, including reduced tax rates for qualified companies and additional deductions for MNCs.⁶⁶ The effective tax rates have thus been significantly reduced. However, decisions concerning the introduction of tax incentives are often highly controversial, given that they are closely related to a country's underlying economic and social policies.⁶⁷

Importantly, if Taiwan introduces a similar incentive program to Singapore or the BENELUX countries (Belgium, The Netherlands and Luxembourg), the Taiwanese authorities will have to consider whether tax benefits derived from the program will be "minimised" by tax legislation in the MNCs' home countries. If the rate of company tax is reduced too much, or if the effective rate is reduced by excessively generous investment incentives, Taiwan will likely be accorded a "tax haven" status by home countries.⁶⁸ If this is the case, tax sparing and/or exemptions might be denied, with the possible application of the Controlled Foreign Companies ("CFC") legislation.⁶⁹ Such a course of action may also make the negotiation of future tax treaties difficult.⁷⁰ By virtue of the CFC provisions in countries such as the USA,⁷¹ Germany,⁷² and Australia,⁷³ tax benefits received by MNCs based in these countries from any incentives that Taiwan offered might be significantly reduced. The CFC provisions generally seek to tax passive or portfolio

⁶⁵ Details of the proposed imputation system in Taiwan are examined in the following section.

⁶⁶ In 1988, the Singaporean government introduced a special tax regime to induce MNCs to the country. See generally Income Tax (Concessionary Rate of Tax for Approved Headquarters Company) Regulations 1988 No S 43 ("the Regulations"). Under the Regulations, qualified holding companies in Singapore are taxed at a reduced rate of 10%: see the Regulations s 3. Also the costs of relocation incurred by MNCs can be written off as expenses against their profits. Other major hosting nations for MNCs' regional headquarters, such as the Benelux countries, also offer generous tax incentive packages. See generally above n 33.

⁶⁷ Issues and implications of tax incentives are discussed later.

⁶⁸ Easson AJ, "Tax Incentives for Foreign Direct Investment in Developing Countries" (1992) 9 *Australian Tax Forum* 387 at 406.

⁶⁹ Ibid. See also Evans K, "Operational Headquarters in Singapore" (1990) 5 *APTIRC Bulletin* 158 at 163-164.

⁷⁰ Details of tax treaties will be discussed in the following section.

⁷¹ See generally above n 20 at U/31.

⁷² See also Evans, above n 69 at 163.

⁷³ (Australian) ITAA, ss 316-468.

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income earned by resident controlled companies in low tax or tax haven countries (or “unlisted countries”) on an accrual basis under the home country’s tax rules. Accordingly, the home country’s revenue authorities are able to avert tax avoidance schemes under which income is accumulated in CFCs incorporated in tax haven countries without being subject to the tax regulations of the home country (normally with higher tax rates). In general, Singapore and the BENELUX countries are classified as listed countries, ie, countries which adopt a “similar” concept of income tax laws. However, as these countries offer substantial tax incentives, such as an OHQ regime, the special regimes are specifically deemed to be “tax haven” operations. Income derived is classified as “concessionally taxed” income⁷⁴ and will be subject to the CFC provisions. Under Australian taxation law, for example, a holding company’s income in Singapore,⁷⁵ Malaysia⁷⁶ and the BENELUX countries is generally classified as concessionally taxed income under the Australian CFC rules.

It is unknown whether the CFC provisions in home countries will affect MNCs’ willingness to operate in countries such as Singapore or the BENELUX countries where comprehensive incentive packages are provided. It may be necessary to go beyond an analysis of the tax benefits in the context of the operations centres alone. The tax laws in home countries may remove or neutralise the tax benefits derived in host countries under the incentive regimes. However, it appears that the CFC and other tax regulations have no significant deterrent effect on MNCs’ operation and investment decisions; in reality, there are significant numbers of MNC holding companies and/or headquarters currently operating in Singapore and the BENELUX countries.⁷⁷ A large MNC presence in these countries explains the fact that the overall benefits received by MNCs under such regimes outweigh the total costs associated with such operations. After all, while tax is an important factor determining MNCs’ investment decisions, other economic and commercial considerations are also taken into account in reaching final decisions. Indeed,

⁷⁴ “Concessionally taxed” income is income that is either not taxed at all, or is taxed at reduced rates to attract a particular form of business or financial activity. It is referred to as “eligible designated concession income” in Australia.

⁷⁵ The following income received in Singapore is also classified as concessionally taxed under the Australian CFC provisions: “Asian currency units”, “approved securities companies, insurance and reinsurance of risks outside Singapore”, “gold bullion, gold futures and financial futures”, “syndicated offshore credit and underwriting facilities”, “offshore managed funds” and “oil futures concession”. Australian Taxation Office (Commonwealth of Australia), *Foreign Income Return Form Guide* (1991) A1.8.

⁷⁶ In addition to the regional operational headquarters scheme in Malaysia, “inward reinsurance business” and “offshore insurance income” is also subject to the “concessional tax” regulations under Australian tax law. *Ibid.*

⁷⁷ For example, more than 300 MNCs have established coordination centres in Belgium. Above n 33 at (i).

with appropriate professional advice, MNCs from countries with CFC legislation are able to plan and formulate strategies for taking full advantage of the system provided in the host country while not breaching the rules, or increasing the taxation burden at home.⁷⁸

IMPUTATION SYSTEM AND TREATMENT OF DIVIDENDS

As mentioned, Taiwan still operates under a classical system. In addition to double taxation of shareholders, other drawbacks of the classical system might include discriminating in favour of debt,⁷⁹ retention of profits and the application of those profits toward less socially productive purposes, and a preference for an unincorporated business structure.⁸⁰ Although no direct evidence has shown that foreign investors will be deterred from investing in classical system countries, these countries are certainly less attractive than those operating under an imputation system, all other factors being equal.

In early 1997, Taiwan's Ministry of Finance ("MOF") presented draft provisions for an imputation tax system as a result of the ruling party's campaign promise in the 1996 presidential election.⁸¹ The proposed system has been subject to various consultation sessions among government officials and participants from the private sector. Some of the proposals have been controversial and raised a great deal of debate among participants, particularly over the issue of "10% additional tax" on a company's undistributed earnings.⁸² The private sector has questioned the practicability of such a proposal. Even within the government, the Ministry of Economic Affairs ("MOEA") and Executive Yuan (the Cabinet) raised concerns as to the industries upon which the tax should be imposed.⁸³ The MOEA and Council for Economic Development and Planning⁸⁴ argued that the additional tax might place Taiwan at a competitive disadvantage. This is particularly so in light of Taiwan's overarching goal of becoming an operation, manufacturing, and research and development centre in the region.⁸⁵ They

⁷⁸ Ibid at (ii).

⁷⁹ While company profits will be taxed twice if using equity financing, debt financing will be more tax effective, as interest payments will normally become tax deductible and hence reduce the company's effective tax payable.

⁸⁰ The highest effective corporate tax rate (55%) is generally higher than the highest personal tax rate (40%).

⁸¹ "The Editorial – Imputation System and Tax Issues on Undistributed Earnings" *Commercial Times Daily* (4 April 1997).

⁸² Ibid.

⁸³ "Failure to Reach a Consensus on the Imputation System Assessment Meeting" *China Times Daily* (7 June 1997).

⁸⁴ Being an branch of the Executive Yuan, the Council is the top organ in implementing economic and industrial policies in Taiwan.

⁸⁵ "Failure to Reach a Consensus on the Imputation System Assessment Meeting" above n 83.

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further argued that among the 21 countries which have adopted the imputation system, only Germany and Iceland impose similar taxes on undistributed earnings.⁸⁶

One of the reasons for implementing a 10% additional tax on undistributed earnings is to raise additional funds to recoup the initial loss of revenues caused by the imputation system. According to the MOF, the estimated annual revenue loss would reach \$NT 20 to 30 billion.⁸⁷ Meanwhile, the government has also planned to increase the value added tax from the current 5% to 7% within two years, starting from 1997.⁸⁸ However, the prime objective of the additional tax is to prevent companies withholding earnings and delaying the process of distribution so that the timing of the tax payment by shareholders can also be deferred⁸⁹ - there will be a strong incentive for companies to engage in such a practice because the current gap between Taiwan's top individual rate (40%) and the nominal company tax rate (25%) is significant. Consequently, although shareholders will be able to claim imputation credits against their dividend income, they will still have to cover the difference between the actual tax rate and imputation credit rate. In 1996, the MOF attempted to increase the current company rate from 25% to 35% in an effort to reduce the gap between the individual and the business enterprise rates, although that proposal was eventually firmly rejected.⁹⁰

Industry officials have criticised the proposal to impose the 10% additional tax because the government has failed to take each industry's specific needs into account. Taiwan's National Chamber of Commerce and Industries pointed out that this would be unfair to companies engaging in capital intensive and/or high technology industries. They normally maintain a higher level of capital reserves compared to their counterparts in other industries because of the nature of their operation (as they normally require larger capital to continue their operations).⁹¹ In response to the criticism, the MOF argued that the majority of capital intensive and high technology industries are already receiving various tax incentives (eg, R&D allowance) and that granting exemptions to these industries would be unfair to more "conventional" industries.⁹² The MOF has not altered its decision to impose

⁸⁶ "Thirteen Questions Raised by the Industry and Business Sectors" *Commercial Times Daily* (19 April 1997).

⁸⁷ This is equivalent to A\$1.4 to 1.5 billion. Above n 83.

⁸⁸ If this is the case, the government will be able to generate an additional NT\$100 billion (approximately A\$5 billion) of revenue. "Value Added Tax Will Be Increased to 7% within 2 Years" *China Times Daily* (1 June 1997). General background of the value added tax regime in Taiwan see Yen CC, "The Republic of China's Experience with the Introduction of Value Added Tax" (1993) 3 *Revenue Law Journal* 125.

⁸⁹ Above n 81.

⁹⁰ Above n 83.

⁹¹ Above n 86.

⁹² Above n 83.

the 10% additional tax on high technology and capital intensive industries, although it promised such industries that it would find other funding sources for their operations. These include the relaxation of certain securities and financial regulations, eg, easing special listing rules and venture capital legislation for hi-tech industries, so that companies in these industries are able to raise the necessary funds through the financial market.

Foreign companies in Taiwan have also strongly opposed the MOF's proposals. The imputation system will provide no economic benefits to them, as foreign shareholders will not be able to claim any imputation credit against their dividend income. In fact, foreign shareholders will be worse off if the additional tax is imposed. Calculated below, the effective rate under the imputation system will be increased to 46% which is 6% higher than the current rate of 40% (see Table 3).

Table 3
Potential effects of the proposed 10% tax on foreign investors⁹³

	Foreign subsidiary in Taiwan
	\$
Profit before tax	100.00
Less: nominal tax rate (25%)	(25.00)
Earnings available for appropriation	75.00
Less: 10 % additional tax	<u>(7.50)</u>
After tax earnings	67.50
Withholding tax (20%)	(13.50)
Net dividend received after tax	<u>54.00</u>
Total tax paid (and the effective tax rate)	<u>46.00</u>

Representatives of foreign companies, such as the American Chamber of Commerce and Industry in Taiwan, have lobbied the government not to impose the 10% additional tax, or at least allow foreign shareholders to claim imputation credits in the same way as domestic shareholders.⁹⁴ After a series of consultations between the MOF and foreign company representatives, the MOF finally agreed that foreign shareholders could claim credits if the company's effective tax rate is more than 25%.⁹⁵ In other words, foreign

⁹³ This is calculated based on the following assumptions:

- (i) companies receive no tax incentives; and
- (ii) companies are fully controlled by foreign shareholders.

⁹⁴ Above n 81.

⁹⁵ "Big Change in Proposed Imputation System: Foreign Investors' Tax Burden Will be Reduced" *China Times Daily* (13 June 1997).

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companies will be able to claim 10% of after-tax earnings as credits as part of their tax calculations (see Table 4).

Table 4
The proposed imputation system tax effects on foreign investors⁹⁶

	Foreign subsidiary in Taiwan
	\$
Profit before tax	100.00
Less: nominal tax rate (25%)	(25.00)
Earnings available for appropriation	75.00
Less: 10 % additional tax	(7.50)
After tax earnings	67.50
Withholding tax on earnings (20%)	(13.50)
Additional Credits (67.5 x 10%)	<u>6.75</u>
Net dividend received after tax	<u>60.75</u>
Total tax paid (and the effective tax rate)	<u>39.25</u>

As calculated above, the effective rate has been reduced from 40% under the classical system, to 38.5%. However, the proposed Taiwanese approach is certainly not the best one in the region. In countries such as Singapore, Malaysia and Australia, foreign shareholders are not subject to withholding taxes if the dividend received is paid as an after-tax distribution, or franked dividends. Dividend withholding tax is only payable to the extent the dividend is paid from untaxed profits, or received as unfranked dividends.⁹⁷ In theory, this is a more logical approach to avoid “economic double taxation” and adheres more closely to the spirit of the imputation tax system. As such, the authorities should allow companies to make their own finance and investment decisions and permit market forces to determine how much of the earnings each company wishes to retain in their on-going operations. Thus it is hoped that Taiwan adopts a similar approach to that of other countries and waives all claims to withhold tax from franked dividend payments to non-residents. This is essential if Taiwan wants to compete against others in becoming a host nation for MNCs’ operations centres in the region.

⁹⁶ This is calculated based on the following assumptions:

- (i) the effective tax rate of the company is higher than 25% (in this case, 32.5%); and
- (ii) companies are controlled by more than 95% of foreign shareholders.

⁹⁷ Generally see CCH, *1997 Singapore Master Tax Guide* at para 218A; CCH, *1997 Malaysian Master Tax Guide* at para 245 A; (Australian) ITAA, ss 128, 128B(3)(ga) and 128D.

WITHHOLDING TAXES

Payments of passive income such as interest, dividends and royalties to non-resident taxpayers are often subject to a withholding tax in the source country. In cross-border capital transactions, withholding tax regimes in host countries can be an important factor in MNCs' investment decisions.⁹⁸ To attract and encourage more capital inflows and investment, many countries, including major financial centres around the world, have implemented various reforms of their withholding tax regimes.

Withholding taxes are widely used in Taiwan. Similar to many other countries, withholding taxes are applied for passive income payments sourced in Taiwan to non-residents. Taxation rates are stated in the following table (see Table 5):

Table 5
Rates of withholding taxes in Taiwan⁹⁹

Type of income	Rate (%)
Dividends:	
- investments approved under the Statute for Investment by Foreign Nationals or Overseas Chinese	20
- other dividend distribution	35
Interest:	
- normal interest income	20
- short-term commercial bills	20
Royalties:	20
Rental income:	20
Other passive income:	20

Withholding taxes are viewed as an especially limiting factor for offshore businesses because they are a tax on *gross* interest¹⁰⁰ in a competitive market where the margins are small.¹⁰¹ The treatment and rate structure applicable to dividends, interest and royalties can have important implications on investment planning, since high withholding taxes on cross border payments frequently result in an unnecessary addition to the overall tax burden of a

⁹⁸ For the impact of withholding taxes on international debt transactions see generally, above n 9.

⁹⁹ Source: above n 30 at TWN 4-070.

¹⁰⁰ As opposed to corporate tax, which is levied on *net* profits.

¹⁰¹ Savage, above n 46 at 53.

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MNC group.¹⁰² In this context, Taiwan's 20% (on average) withholding tax rate on dividend payments is an inordinately high burden. Since withholding taxes will arise when regional subsidiaries remit their profits (ie, dividends) to their holding company and when the holding company pays to the ultimate parent entity, double payments of withholding taxes can become a significant issue in deciding where MNCs will set up their regional centres/holding companies.¹⁰³

Many developing countries impose relatively high levels of withholding taxes on direct dividends. The high rates take into account that dividends, interest and royalty flows are typically one sided between developing countries and recognise that the source country's right to tax, for administrative reasons, is best exercised through withholding taxes.¹⁰⁴ This imbalance of payment flows, however, may gradually be reduced as a country's economy develops.¹⁰⁵ For instance, Hong Kong¹⁰⁶ and Singapore,¹⁰⁷ which have substantial levels of outward investment, do not apply withholding taxes on dividends and a low level of taxation is imposed on interest and royalties. Along with these countries, Taiwan is becoming a major capital exporter in the region and should also consider eliminating or reducing the level of withholding tax. As suggested in the OECD Model Taxation Convention, withholding tax for dividend payments should be limited to 5% or eliminated entirely.

A regime that allows withholding tax exemptions on passive income payments to non-residents is common in major international financial centres

¹⁰² Ibid.

¹⁰³ For example, assume a US based MNC has an affiliated company in the Philippines ("PHILCO") which is controlled by the MNC's regional holding company in Taiwan. The dividends remitted to the US by the PHILCO are subject to a Philippines' withholding tax of 25% according to the US-Philippines double tax agreement. There are no tax treaties between Taiwan and the US or Taiwan and the Philippines, so the standard rate of withholding tax, ie, 20%, are applied on any out remittance from Taiwan by the Taiwanese authority and 15% on outward remittance from the Philippines¹⁰³ by the Filipino authority. It would be illogical for the MNC to route dividends from the Philippines through the holding company in Taiwan. Such a course of action would attract withholding taxes twice, ie, 35% of withholding tax in total, compared to 25%, if directly remitted back to the US.

¹⁰⁴ Sasseville, above n 1 at 10.

¹⁰⁵ Ibid.

¹⁰⁶ Above n 20 at H4/7.

¹⁰⁷ Because of the imputation system operating in Singapore, the usual practice is to provide a zero rate on dividends paid out of Singapore. It seems that Singapore's preferred position on interest and royalties is a flat 15% maximum tax rate, though 10% is often conceded and may have become the norm now for interest payments. See generally Vann R (ed), *Tax Treaties: Linkages Between OECD Member Countries and Dynamic Non Member Economies* (1996), above n 1 at 68.

and host countries for MNCs' holding companies.¹⁰⁸ To minimise MNCs' withholding tax liability and make Taiwan more competitive, legislation could be implemented that would either waive withholding taxes unilaterally or minimise the tax by entering into double taxation agreements containing provisions with regard to the rates of withholding tax. For example, as suggested above, all franked dividends paid to non-residents should be exempt from withholding tax. Furthermore, certain foreign source dividends that have passed through a resident company to a non-resident shareholder could be made exempt from both income and withholding taxes.¹⁰⁹ While introduced in the context of measures designed to foster the establishment of regional headquarters in Taiwan, the dividend withholding tax exemption should also be applied to all companies incorporated in Taiwan. The other alternative to reduce withholding tax is to enter into tax treaties with other countries with specific provisions to reduce the level of withholding taxes. In the absence of treaties, the burden of high withholding taxes will probably discourage the pursuit of a particular investment by foreign investors in Taiwan.¹¹⁰ Taiwan will have to establish a thorough network of tax agreements to become an effective regional operations and financial centre.

INTERNATIONAL TAX TREATIES

Double taxation agreements (or tax treaties) are not the fuel of the engine of international investment, nor do they represent the driving force behind these flows.¹¹¹ Instead, they serve as the oil that lubricates the engine: a network of double taxation conventions does not in itself create investment, but without the oil, the whole engine may stop.¹¹² The important role of tax treaties cannot be dismissed in the decision making processes of a potential foreign investor. Tax coordination at various levels would aid in the resolution of potential conflicts arising out of the use of different bases of taxation across countries.¹¹³ In summary, specific objectives of the typical provisions found in tax treaties include:¹¹⁴

- 1 the elimination of double taxation;
- 2 the allocation of taxing rights and income source between contracting

¹⁰⁸ Scarlata, above n 35 at 81.

¹⁰⁹ This is suggested under the Australian OHQ proposal and was implemented under the Taxation Laws Amendment Bill No 3, 1994 (which commenced after July 1994). This special exemption is not restricted to a RHQ and will be available to all qualifying foreign source dividends.

¹¹⁰ Hammer, above n 52 at 124.

¹¹¹ Gjesti P, "Overview and Summary of Discussions on Tax Treaties and Investment Flows" in OECD (ed), above n 2 at 102.

¹¹² Ibid.

¹¹³ Tax Policy Division of IMF, "Tax Policy and Reform for Foreign Investment in Developing Countries" in OECD (ed), above n 2 at 165.

¹¹⁴ Sasseville, above n 1 at 12.

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- states;
- 3 the prevention of tax avoidance;
- 4 the prevention of certain forms of tax discrimination; and
- 5 the resolution of tax disputes.

Double tax agreements are a major step forward where it is not clear which state can tax the income and where there are no accompanying source rules. In this respect, bilateral tax treaties are thought to offer investors tax certainty and, in many cases, a reduction of the tax burden. One of the features identified in major international financial centres and/or major host nations of MNC holding companies is the existence of an extensive network of double taxation agreements.¹¹⁵ The Netherlands, Luxembourg and Singapore are good examples. To date, the Netherlands has concluded 57 tax treaties,¹¹⁶ while Singapore has concluded 32.¹¹⁷ In contrast, Taiwan has only recently commenced negotiating double tax agreements. Only a few comprehensive tax treaties have been concluded with the following countries: Singapore, South Africa, Paraguay, Indonesia, Malaysia, New Zealand, Vietnam and Australia. These countries include some of the major destinations of Taiwanese investment. However, for political reasons, it is impossible for Taiwan to conclude any kind of tax agreement with China. This is a significant problem as MNCs will not be able to receive any taxation benefits through the tax treaties if their holding companies are incorporated in Taiwan and plan to invest in China, the largest emerging market in Asia. Nevertheless, if planned properly, the problem can be solved by a “treaty shopping” technique, provided an extensive treaty network is available in Taiwan. Unfortunately, the size of Taiwan’s tax treaty network is too limited and there are too many inadequacies in the current treaties to facilitate “treaty shopping.”

As one of the biggest trading and capital export nations,¹¹⁸ the international dimension of tax policies has become an important issue to Taiwan’s government and business community. It is also true that the increasing dominance of MNCs in international trade and the increased integration of these companies makes it difficult to allocate the tax base between the different countries in which an MNC enterprise operates.¹¹⁹ Thus, for small and perhaps not so small open economies like Taiwan, any new tax system should not be too far out of line with major trading partners.¹²⁰

¹¹⁵ Scarlata, above n 35 at 81.

¹¹⁶ Above n 20 at N/5-N/6.

¹¹⁷ CCH, *1997 Singapore Master Tax Guide* at para 1798.

¹¹⁸ Taiwan was the 9th largest trading nation in the world (US\$219 billion in 1996). “Ranking of International Trade Volume” *Yazhou Zhoukan: The International Chinese Newsweekly* (23-29 June 1997) at 26.

¹¹⁹ Above n 5 at 14.

¹²⁰ *Ibid* at 10.

Despite the emergence of Taiwan as a regional economic power and a capital exporting country, many countries in the world still refuse to enter into double tax agreements with Taiwan.¹²¹ Taiwanese government officials have publicly acknowledged the problem, although the details of why many countries have refused have so far not been fully explained.¹²² At one stage, the MOF considered including a special provision for foreign companies from treaty nations to be exempt from the "10% additional tax" under the new imputation system.¹²³ The MOF hopes MNCs from non-treaty nations can influence their home countries to consider the possibility of signing a tax treaty with Taiwan. However, the most significant obstacle which Taiwan currently faces is that many countries do not recognise Taiwan as a sovereign nation, capable of entering into any agreement with other states under international law. Rather, it is recognised as a "provincial government" of China¹²⁴ and any official contact between Taiwan and other countries is likely to provoke indignation and opposition from the government in Beijing. Entering into treaties with other countries is, for Taiwan, a highly political exercise and is part of Taiwan's "treaty diplomacy" to break through its diplomatic isolation.¹²⁵ Some countries have adopted a pragmatic approach on treaty issues. For example, the Australian Agreement, concluded in 1996, was signed by a representative office (ie, a de facto embassy) for each government.¹²⁶ By doing so, Australia is able to maintain a constructive commercial relationship with Taiwan without violating its "one-China" policy with the PRC.

Despite its diplomatic isolation, Taiwan will need to continue seeking tax treaties with other countries if it wishes to become a financial and commercial hub for MNCs in the region.¹²⁷ In comparison with the tax treaty networks of

¹²¹ The most notable is Taiwan's largest trading partner, the US. It is reported that the US government refuses to sign a tax agreement because of "diplomatic" and "political" reasons. See "Tax Treaty with Canada – Overseas Chinese in Canada Against It" *China Times Daily* (21 August 1997).

¹²² "Special Treatment to Foreign Business Will be Considered in Tax Treaty Talks" *China Times Daily* (18 April 1997).

¹²³ Ibid.

¹²⁴ For example, the joint communique between Australia and China, as stated (quoted in Godwin, above n 10 at 50):

the Australian Government recognises the government of the Peoples' Republic of China as the sole legal government of China and acknowledges the position of the Chinese Government that Taiwan is a province of the Peoples' Republic of China.

¹²⁵ Above n 121.

¹²⁶ The Australia-Taiwan agreement was signed by the Australian Commerce and Industry Office (based in Taipei) and the Taipei Economic and Cultural Office (based in Canberra). Other countries have also signed tax agreements under the capacities of commercial or other diplomatic offices of each country.

¹²⁷ For the first time, the Canadian authorities "approached" and requested Taiwan to sign an agreement. This is because Taiwan has emerged as one of Canada's biggest trading partners and there are substantial Taiwanese investments (and

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the Netherlands and Singapore, Taiwan still has much work to do in establishing a thorough network. Without comprehensive tax treaties with home countries of MNCs, uncertainties over taxing rights and related issues will remain unresolved while other tax disincentives (such as high withholding tax rates) may make MNCs unwilling to invest in Taiwan.

TREATMENT OF FOREIGN SOURCE INCOME

Having discussed Taiwan's tax treaty policy and its efforts in extending its network of agreements, it is also important to discuss Taiwan's current tax regime governing foreign source income. From an MNC's perspective, policies and tax regimes on the treatment of foreign source income are very important in deciding whether the country is to become the destination for their holding companies or profit centres in the region.

Under the current law, resident individuals in Taiwan are only subject to income tax on local source income while resident companies (and other profit-seeking business enterprises) are taxed on worldwide income. Depending on the structure of the investment, the timing of assessment on foreign source income differs significantly. Income derived by foreign *branches* of a Taiwanese company is assessed on an accrual basis, whereas a cash basis is applied to foreign income derived by *subsidiaries* of a Taiwanese company.¹²⁸ Foreign tax paid by overseas branches of a Taiwanese company will be credited against tax liability in Taiwan, up to an amount equal to the Taiwan tax liability attributable to the foreign source income.¹²⁹ Profits earned by an overseas subsidiary incorporated outside Taiwan, however, are exempt from Taiwan's tax assessment until such profits are actually distributed in the form of dividends or otherwise, to the parent entity in Taiwan.¹³⁰ Where foreign dividends are received the foreign tax credit is limited to withholding tax on the dividends except where a tax treaty applies.¹³¹ Unused foreign tax credits may not be carried backwards or forwards.¹³²

Taiwan's foreign tax credit provisions are provided in the Income Tax Law on a unilateral concession basis; ie, a company is allowed to claim foreign tax

immigrants) in Canada. See above n 121. However, Taiwan withdrew from negotiation after public pressure in Taiwan. Taiwanese immigrants were afraid of disclosing their assets in Taiwan to the Canadian authorities. Under the proposed amendments to the tax law, Canadian residents must disclose all of their assets if their total assets are more than Canadian \$100,000. Ibid.

¹²⁸ Chang SF, "Tax Policies on Foreign Direct Investment: the Chinese Taipei Perspective" in Vann R (ed), above n 1 at 28.

¹²⁹ Income Tax Law Art 3.

¹³⁰ Huang, above n 23 at 484.

¹³¹ Above n 30 at 86221.

¹³² Ibid.

paid as a credit against its total tax liabilities, even in the absence of a tax treaty.¹³³ In a broad sense, the unilateral credit system should be perceived as a positive step to minimise double taxation on foreign source income derived by branches of a company incorporated in Taiwan. This is particularly important as Taiwan is now a capital exporter with increased overseas expansion by Taiwanese business entities. Concurrent with the APROC initiative, the credit system will encourage MNCs to establish a major presence in Taiwan. In recognising the importance of a unilateral concession regime, the Singapore authorities, for example, have also granted unilateral relief to residents on income derived from professional, consultancy, and other specified services¹³⁴ and sourced in certain countries with which Singapore has no double taxation agreements.¹³⁵

Currently, a foreign credit system and unilateral relief is limited only to branch operations of Taiwanese companies while the exemption method is applied to cover foreign source income derived by subsidiaries of Taiwanese companies. The end result will vary significantly with the method used. For example, assume a wholly owned Taiwanese subsidiary operating in a classical system country derives \$100 million of taxable income and pays 30% foreign income tax. Assume that the subsidiary elects not to declare a distribution of after tax dividends (ie, no remittance back to Taiwan). During the same year, assume that the parent company in Taiwan generates \$200 million of Taiwan source income. Under the exemption method, the net profit for the group (or cash on hand) is \$220 million calculated as shown in Table 6:

Table 6
Exemption method on foreign source income (no remittance)

	Foreign source income and tax paid (30%)	Assessable Taiwan source income	Total taxable income in Taiwan (25%) ¹³⁶	Final tax result
Taxable income	100.00	200.00	200.00	300.00
Income tax paid	<u>(30.00)</u>	-	<u>(50.00)</u>	<u>(80.00)</u>
Profit after tax	<u>70.00</u>	-	<u>150.00</u>	<u>220.00</u>

¹³³ Chang, above n 128 at 28.

¹³⁴ Above n 20 at S/37. Included in the specified services are approved operational headquarters and approved finance and treasury centre services. Ibid.

¹³⁵ Ibid.

¹³⁶ Although the resident Taiwanese company is taxed on worldwide income, its foreign source profits will not be taxed until the subsidiary declares dividends, as offshore income is only taxed on a cash basis.

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If dividends were remitted back to Taiwan, based on the assumption that a 15% withholding tax was deducted at the source of income, the parent company's profit after tax in Taiwan would be \$213 million (see Table 7).

Table 7
Exemption method on foreign source income (full remittance)

	Foreign source income and tax paid (30%)	Assessable Taiwan source income	Total taxable income in Taiwan (25%)
Taxable income (\$m)	100.00	200.00	270.00 ¹³⁷
Income tax paid	<u>(30.00)</u>	-	<u>(67.50)</u>
Profit after tax	70.00	-	202.50
DWT @ 15%	<u>(10.50)</u>	-	-
Dividends remitted	59.50	-	-
Foreign tax credit	-	-	<u>10.50</u>
Profit after tax	-	-	<u>213.00</u>

Using this scenario, there will not be any difference between the exemption and credit system, when comparing the group's final result. However, if all dividends were remitted back to Taiwan, the group's profit after tax under the credit system would be higher than the result calculated under the exemption method (see Table 8).

Table 8
Foreign tax credit system on foreign source income (full remittance)

	Foreign source income and tax paid (30%)	Assessable Taiwan source income	Total assessable income in Taiwan (25%)
Taxable income (\$m)	100.00	200.00	300.00
Income tax paid	<u>(30.00)</u>	-	<u>(75.00)</u>
Profit after tax	70.00	-	225.00
DWT @ 15%	<u>(10.50)</u>	-	-
Dividends remitted	59.50	-	-
Foreign tax credit	-	-	<u>25.00</u>
Profit after tax	-	-	<u>250.00</u>

Note the maximum foreign tax credit is limited to \$25 million, which is the

¹³⁷ Total of the assessable Taiwan source income (\$200 million) and gross amount of after tax overseas profit before dividend withholding tax (\$70 million).

rate applicable for the same amount of assessable income in Taiwan. Although the final tax figures might be different, depending on the tax systems in both host and home countries,¹³⁸ in general terms it appears that a company will be better off if it is incorporated in a jurisdiction which utilises the credit system.

Under the current law, Taiwanese companies will be better off if their subsidiaries remit no dividends to Taiwan and accumulate retained earnings overseas. This is because only partial relief is available on withholding tax paid when the dividends are remitted to Taiwan, rather than full credit on the underlying income tax paid overseas. When the subsidiary is operating in a country which operates an imputation system (such as Australia), where franked dividends paid to non-residents are exempt from withholding taxes, the parent entity will have nothing to claim against its overall liability in Taiwan. If this is the case, subsidiaries of a Taiwan based company (eg, MNC's regional holding company) will not remit all dividends back to the parent entity to minimise the overall tax liability of the group. This practice, in theory, will defeat the purpose of a holding company or treasury centre under the APROC initiative; ie, centralising operations and finance functions for the group of companies.

Without the foreign tax credit regime in place, Taiwan cannot hope to function as a regional operations centre for MNCs. While unilateral relief is available to branches in relation to foreign source income, the same relief should also be extended to subsidiaries of companies incorporated in Taiwan, including MNCs' holding companies. Furthermore, Taiwan's unilateral relief is likely to fall short of the relief afforded under the terms of a double tax agreement. This will be the case when Taiwan-based enterprises invest in other countries where substantial tax incentives are provided. The (unilateral) credit system will cancel out the tax benefits offered by host countries because of the lower tax paid and hence the limited credit available to offset overall tax liability. The result may be damaging to capital importing countries which are taking steps to attract foreign investment through tax incentives.¹³⁹ Taiwan itself may be hurt as well. MNCs may be reluctant to establish their regional holding companies or operations centres in Taiwan since these companies will not be able to enjoy the tax incentives offered by other regional countries if they operate from Taiwan.

Irrespective of Taiwan's difficulty in concluding double tax treaties, one possible solution is to incorporate "tax sparing" provisions into its double tax

¹³⁸ For example, there will be differences because of the following factors: classical or imputation systems used in the host country (eg, withholding tax will be affected), timing of assessment in home countries (eg, whether the CFC provisions are in place) and both effective and nominal tax rates in both host and home countries.

¹³⁹ Shepherd, above n 3 at 109-110.

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agreements with other countries, including both capital exporting and importing nations. The tax sparing provisions enable the tax that would have been charged by the developing country in the absence of the incentive to be offset against the liability of the enterprise in its home territory. This will clearly be of great value to host countries, although capital exporting countries like Taiwan may have to sacrifice, or “subsidise”, some of their tax revenues from investments made by entities of host nations.

The OECD countries have gradually become less liberal with respect to the inclusion of tax sparing provisions in their tax treaties.¹⁴⁰ Typically, they will allow tax sparing only with respect to certain identified incentives or activities and will limit the time of the application of the tax sparing provisions.¹⁴¹ However, developing countries seek the inclusion of tax sparing provisions in their tax treaties with other developing countries.¹⁴² Taiwan’s attitude toward tax sparing appears consistent with the OECD trend. In double tax treaties involving Taiwan, tax sparing provisions have been included only in limited cases.¹⁴³ A leading Taiwanese tax official stated that tax sparing provisions would only be applicable on a reciprocal basis and on the following conditions:¹⁴⁴

- 1 to be eligible for the applicable credit, the claiming party and its investment have to be approved by the competent authority of both countries;
- 2 the scope of the application is limited to the foreign direct investment, and the forgone foreign tax is calculated in accordance with specific incentive provisions of the host country; and
- 3 the application of tax sparing credit is limited to a specific period of time. Both countries can extend the application period by mutual agreement.

Taiwan will benefit from tax sparing provisions if a comprehensive tax incentive program is introduced. To preserve Taiwanese business interests overseas and to encourage MNCs to invest in Taiwan, insertion of the tax sparing provisions into all tax agreements signed by Taiwan is recommended.

¹⁴⁰ Sasseville, above n 1 at 9.

¹⁴¹ Ibid.

¹⁴² Ibid.

¹⁴³ As an example, there are no tax sparing provisions in the Taiwan-Singapore Double Tax Agreement, despite the presence of such provisions in many other double tax agreements that Singapore has signed. See the Singapore-Taiwan Double Tax Agreement.

¹⁴⁴ Chang, above n 128 at 31.

TAX INCENTIVES

In the late 1980s, almost all OECD countries reformed their income tax systems. They moved away from tax incentives towards greater tax neutrality and competitive rates of taxation in an increasingly global economy.¹⁴⁵ In contrast, developing countries such as the Asian Newly Industrialised Countries ("NICs"), have not followed this trend. The Asian NICs continue to rely on incentives such as concessionary tax rates and/or tax holidays and attribute part of their economic success to a tax policy that relies on such incentives.¹⁴⁶

The objective of any tax incentive is to encourage investment that would not otherwise occur. The benefits flowing from that investment must outweigh the costs. It is difficult to conclude that taxation incentives provide an effective way of encouraging industrial development. Opponents of tax incentives say that the costs are substantial and question the use of tax incentives, given that it is not certain how effective they are.¹⁴⁷ They also claim that capital may be attracted to inappropriate activities or locations with potentially adverse implications for investors and the country itself.¹⁴⁸ On the other hand, supporters of incentives argue that the benefits almost certainly outweigh the costs of providing appropriately targeted incentives.¹⁴⁹ Supporters point out that some countries have used taxation incentives as an essential component of industrial development policy.¹⁵⁰ However, empirical studies are inconclusive as to the impact of taxation upon investment decisions.¹⁵¹ Nevertheless, some tentative conclusions can be drawn:¹⁵²

- taxation affects decisions to invest, and the funds available for investment;

¹⁴⁵ Sasseville, above n 1 at 9.

¹⁴⁶ World Bank, *The East Asian Miracle – Economic Growth and Public Policy* (1993) 228. See also Sasseville, above n 1 at 9.

¹⁴⁷ These costs include tax leakage; domestic taxpayers subsidising foreign investors; effective discrimination against domestic investors; distortions in international trade; and the possibility of provoking a regional incentives war. Bentley D, "Tax Incentives: Should Australia Follow Asia's Lead?" (1996) 70 *ALJ* 191 at 195. See also Easson, above n 68 at 390-392.

¹⁴⁸ Anderson, above n 4 at 28-29.

¹⁴⁹ The benefits include: increased revenue from new investments; increased revenue for industries associated with the foreign investments; job creation and skill enhancement; improved balance of payment figures; and improved cultural, economic and social ties with both investing nations and the other countries where they invest. Bentley, above n 147 at 196.

Anderson, above n 4 at 28-29.

¹⁵¹ Easson, above n 68 at 392.

¹⁵² These studies include Ross SG and Christensen JB (1959), Chen-Young PL (1967), Guisinger SE (1985), Wallance CD (1990), Commission of the European Communities (1992), noted in Easson, above n 68 at 392-394.

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- once a decision to invest abroad has been reached, taxation affects where to locate that investment;
- the importance of taxation may vary according to the type of investment;
- the importance of taxation may also vary according to the home country of the investor;¹⁵³
- taxation has a greater influence upon subsequent operational decisions, in particular whether, where and how to reinvest earnings, than upon the initial investment decisions.¹⁵⁴

Although it is difficult to evaluate the contribution of tax incentives to the outstanding performance of the Taiwanese economy, it is generally acknowledged by the Taiwanese authorities that sound tax policy and incentives, have contributed partly to the island's impressive economic performance. The following tax incentives have been widely used at different stages during Taiwan's economic development:¹⁵⁵

- accelerated depreciation;¹⁵⁶
- investment tax credit;¹⁵⁷
- research and development tax credit;¹⁵⁸

¹⁵³ Frank found Japanese and American investors to be more concerned with tax incentives than were investors from Europe. Frank I, *Foreign Enterprise in Developing Countries* (1980), noted in Easson, above n 68 at 395.

¹⁵⁴ This may be of particular importance, since a high proportion of total foreign direct investment comes from reinvested earnings. See also OECD, *Investment Incentives and Disincentives and the International Investment Process* (1983), *ibid.*

¹⁵⁵ Chang, above n 128.

¹⁵⁶ A company limited by shares may elect to use accelerated depreciation on certain qualified fixed assets. Instruments and equipment exclusively used for research and development, quality inspection, energy saving or energy substitution may be depreciated over two years. Depreciation of fixed assets used in industrial restructuring and/or operation and productivity improvement in designated industries, may be shortened by one-half, over the prescribed service life under the EIT. Above n 20 at T-7.

¹⁵⁷ *Ibid.* Investment tax credit may be granted to a company "limited by shares" on its purchases of qualified pollution control equipment or technology and automation equipment. The investment tax credit is 5% to 20% of acquisition cost. The investment tax credit may be applied against the EIT liability. Any unused credits may be carried forward for four years. The annual credit amount, except for the last carry forward year, is limited to 50% of the EIT payable for the current year.

¹⁵⁸ *Ibid.* 20% of the funds used in research and development, professional personnel training, and creation of internationally acceptable brands of products may be taken as credit against the income tax payable for that year. Any unused credit may be carried forward for four years. However, the credit, except for the last year, cannot exceed 50% of the income tax payable.

- important technology and venture capital tax credit;¹⁵⁹
- losses on outward foreign investment;¹⁶⁰
- merger encouragement;¹⁶¹
- retained earnings benefits;¹⁶² and
- deferral of dividends payments.¹⁶³

These incentives are mainly designed to upgrade Taiwan's industrial capacity and transform Taiwan into a technology-driven nation. They have also been used to assist Taiwan's businesses to become more competitive internationally through "merger" schemes. These incentives have primarily targeted manufacturing and export industries rather than service industries, however, these incentives seem inadequate to foster the development of Taiwan's service industries and transform Taiwan into a financial and operations centre in the region.

On the other hand, Taiwan's main rival, Singapore, has been remarkably successful in attracting the headquarters of MNCs. Tax incentives are only part of the reason for that success; what tax incentives do achieve, however, is a reduction in the overall tax burden for MNCs.¹⁶⁴ For instance, Singapore has a comprehensive tax treaty network that reduces withholding taxes on passive income payments made to Singapore. Qualifying foreign dividend income remitted to Singapore is exempt, which means that the recipient only has to pay withholding tax in the country of origin.¹⁶⁵ In addition, it offers a concessionary 10% tax rate to qualified headquarters in Singapore. These

¹⁵⁹ Ibid. 20% of the amount invested in important scientific technological or/and venture capital enterprises may be claimed as tax credit against income tax. The tax credit, however, may not exceed 50% of the income tax for that year. The unused credit may be carried forward for the next four years.

¹⁶⁰ Ibid. Qualified outward investment in response to the government policy by a company may result in 20% of such investment to be claimed as "a loss reserve from outward investment" deductible from taxable income. If after three years such losses have not occurred, the reserve must be reversed for tax purposes.

¹⁶¹ Ibid. Profit seeking enterprises specifically approved by the Ministry of Economic Affairs for merger, to promote efficient operation and management, may qualify for exemption from stamp duty and deed tax created by the merger. In addition, the "land value increment tax" from a transfer of land from the merger can be registered as tax payable until the title to the land is transferred again.

¹⁶² Ibid. A company is allowed to retain its earnings up to the level of its paid-in capital without triggering further taxes. However, under the new imputation credit provisions, this incentive is to be abolished.

¹⁶³ Ibid. Share dividends received by shareholders are exempt for tax purpose if the enterprise recapitalise the distribution amount in research and development, quality inspection, renewal of machinery and equipment, conservation of energy or prevention of pollution. Chang, above n 128 at 30.

¹⁶⁴ Bentley, above n 147 at 194.

¹⁶⁵ Ibid.

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incentives make it a very attractive location even before all of Singapore's non-tax advantages are considered.¹⁶⁶ Similarly, Belgium's experience has also demonstrated that a sophisticated incentive system will also directly or indirectly attract MNCs to establish their regional operations centres in the country.¹⁶⁷ The Malaysian government has also implemented a scheme similar to Singapore's to induce MNCs to establish their OHQ there.¹⁶⁸

It has been approximately three years since the government in Taiwan announced the APROC plan. Although it has already acknowledged the importance of the tax regime since the plan was launched, the government has not yet produced a set of tax initiatives for MNCs to assess.¹⁶⁹ While Taiwan can offer many attractive features, such as a skilled labour force and solid manufacturing base, these are outweighed by disadvantages when its tax system is compared to places such as Singapore. The Singaporean, or even Malaysian regimes which are designed to induce MNCs, are far more sophisticated and clearly outlined.

The Taiwanese Government is afraid of losing tax revenue by introducing tax concessions, even though traditionally, tax revenue only counts as a small proportion of the country's GNP.¹⁷⁰ As in other developing countries,

¹⁶⁶ Ibid.

¹⁶⁷ Belgium has a sophisticated tax system for its "coordination centres" scheme. Now more than 300 MNCs, including IBM, BP, AT&T, EXXON, Volvo and Coca-Cola, have established their coordination centres in the country. Above n 33 at (i).

¹⁶⁸ Tax incentives have been designed to encourage the establishment of operational headquarters ("OHQ") of MNCs. Such OHQ's are required to provide a full range of qualifying services to their subsidiaries in the Asia Pacific region. To qualify, an OHQ must have paid up capital exceeding M\$0.5 million with business expenditure more than M\$1.5 million per annum. Qualifying companies receive a concessionary tax rate of 10% on management fees, royalties, interest and dividends for between 5 and 10 years. Dividends received by an approved OHQ are also exempt from tax for a period of 10 years. Losses arising from the provision of qualifying services can be carried forward and deducted against income from the same source. Marks, above n 60 at 62.

¹⁶⁹ The only available public statement produced by the government states that "it intends to develop a set of taxation rules in governing financial transactions taxation rules in accordance with generally accepted international practices." See above n 11 at 37.

¹⁷⁰ For example, tax revenue as a percentage of GNP in Taiwan is approximately 18.2%, which is ranked 42 in comparison with other countries around the world. It is slightly higher than Korea's 18.1%, Japan's 17.8%, Singapore's 17.1% and Hong Kong's 8.9%. The general trend shows that European countries have on average higher percentages while, in many Asian countries, the percentage of tax revenue as part of GNP fell between 1980 and 1994, even as prosperity increased. "Vital Signs – Tax Contributions" *Asiaweek* (18 April 1997); Council for Economic Planning and Development, *Taiwan Statistical Data Book* (1996) 164.

Taiwan's bureaucrats are concerned about possible tax leakage. The official view is that a concessional tax regime is not required, considering Taiwan is now facing an annual national budget deficit.¹⁷¹ Departing from the traditional view of tax incentives, Deputy Minister of Finance, Yen Ching-Chang stated that tax incentives are surely a useful policy tool to foster certain industries, however, such a policy should not be encouraged if it requires significant sacrifice of the government's revenues.¹⁷² However, it is not clear whether this is a sign for the government to gradually reduce its current level of tax incentives as its western counterparts have done in the late 1980s.

Nevertheless, to become a regional financial and operations centre, Taiwan will require an institutionalised taxation regime to attract MNCs. This system does not have to be entirely new. A concessional regime could be modified to remove uncompetitive features and disincentives of the current taxation system so that Taiwan can at least match regimes in other regional countries. Removing or modifying uncompetitive factors does not mean that the Taiwanese system has to be similar or identical to the systems used in countries such as Singapore or Malaysia. It merely means that while preserving the unique features in the tax system due to the social, economic and political background in Taiwan, the Taiwanese Government will have to minimise any potential impact on MNCs caused by the negative factors in the current tax system.

SUMMARY OF RECOMMENDATIONS

Recommendations can be made with regard to taxation and the role it plays in the wider overall aim of developing Taiwan into a regional operations centre.

- The effective tax rate in Taiwan is relatively high compared to other regional centres including Hong Kong, Singapore and Malaysia. The government should address this issue immediately and reduce the effective rate to a more competitive level.

¹⁷¹ Taiwan has suffered a budget deficit in the last several years as a result of the country's US\$310 billion Six Year National Development Plan. See Wan TH, "Comparative Approaches to Regulatory Safety and Soundness" in Norton JJ, Cheng CJ and Fletcher I (eds), *International Banking Regulation and Supervision: Change and Transformation in the 1990s* (1994) 267. In 1995, the deficit reached NT\$519 billion (approximately A\$26 billion), the highest in three decades. Council for Economic Planning and Development, *Taiwan Statistical Data Book* (1996) 151. See also Liu LS, "Creating an International Financial Center: The Case of Taiwan, ROC" in Norton JJ, Cheng CJ and Fletcher I (eds), *International Banking Operations and Practices: Current Developments* (1994) 133.

¹⁷² "MOF Against the Double Benefits to Hi-Tech Industry" *China Times Daily* (27 July 1997).

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- The government can reduce the effective tax rate by increasing the deduction bases for qualified MNCs. These can include deductions on relocation costs and for the transfer of losses among companies in the same group. Another method of reducing the effective rate is to replace current corporate taxation with the imputation taxation system.
- If an imputation system is introduced, all franked dividends paid to non-resident shareholders should be exempt from the withholding tax regime. The 10% additional tax should be used as a temporary measure to ease the government's financial difficulties. In the long term, this tax should be abolished. The government also needs to reconsider increasing its tax rate from the current 25% to a level close to the highest personal marginal rate (40%). If an imputation tax system is introduced, the increased tax burden on a company will be neutralised, as shareholders will be compensated by imputation credits. It would not then be necessary for the government to continue imposing the 10% additional tax.
- The government needs to extend its unilateral credit relief on foreign tax paid to subsidiaries of Taiwan based companies.
- To reduce its current withholding tax level, the government could more actively seek to enter into tax treaties with other countries. Certain dividend flows through holding companies in Taiwan should also be exempt from a withholding tax.
- Despite political and diplomatic difficulties, Taiwan should continue to develop a "pragmatic" relationship with its trading partners with an aim to sign tax treaties with major countries in the world. These treaties should also include tax sparing provisions so that all benefits generated from incentive schemes (overseas and domestic) can be fully preserved by MNCs. It is paramount for Taiwan to build an extensive treaty network if it wants to become an operations centre for MNCs in the region.
- The authorities will need to reform current tax practices to reach accord with internationally accepted standards. For example, the government needs legislation to regulate operations under a trust structure.
- The government will need to consider whether it is necessary to introduce an "APROC" incentive package to induce MNCs to Taiwan. It should also be aware that such an incentive regime may be sanctioned by the tax regulations of the MNCs' home countries, which may directly or indirectly make treaty negotiations more difficult.

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Taiwan - Taxation Perspective

Without significant improvements in Taiwan's taxation system, it will be difficult for Taiwan to replace its closest rivals such as Singapore and Hong Kong as a leading regional finance and operations centre.