Taxation Systems on Taiwan Outward Investment in China

Der-cherng Lo
Department of Public Finance
National Chengchi University

January 2008

Contents of presentation

I. Introduction
II. Current regulations on Taiwan outward investment in China
III. Taxation systems on Taiwan outward investment in China
IV. Double taxation issues
V. Conclusions

I. Introduction

In order to promote domestic economic development and attract inward investment from overseas Chinese and foreign nationals, the government of Taiwan legislated two milestone statutes which were the "Statute for Investment by Foreign Nationals" in 1954 and the "Statute for Investment by Overseas Chinese" in 1955. From 1952 to 2006 approved overseas Chinese and foreign investment has been accumulated to US$78.69 billion[1]. Accompanied with tax exemption legislations such as "Statute for Prizes, Awards and Investments" in 1960 and "Statute for Upgrading Industries "in 1991 and export processing zone, science parks establishments drove Taiwan's economic growth in the past 50 years. Economic growth has accumulated considerable amount of foreign exchange reserves[2] and pushes production costs up to a substantial level. The enterprises have ability and necessity to invest outside.

In 1990s China investment fever phenomenon caused China as Taiwan's hottest outward investment area. According to China Ministry of Commerce data, as of 2006 Taiwan is number five investor in China. The realized FDI value was US$43.89 billion.[3] Due to the geographic location and culture closed relation, Taiwanese entrepreneurs prefer to invest in China. Besides, tax exemption or tax deduction preferential treatments play an important role during the capital flow process. In the earlier stage, China used a lot of tax exemption policies to attract foreign investors. Taiwan experienced from FDI inward country to outward country[4].

After China reformed her economic system and adopted open door policies to attract inward investment, across the Taiwan Strait investment activities have become more and more vigorous. Every country has own taxation territories. Multinational income taxation is a complicated and serious issue in tax system.

In this paper, I will introduce current regulations on Taiwan outward investment in China, taxation systems on Taiwan outward investment in China, double taxation issues and finally is conclusions.

[1] Please refer table 1.
[2] It is US$270 billion at the end of 2007 November.
[3] Please refer table 7.
[4] Please refer table1 to table5.

II. Current regulations on Taiwan outward investment in China

The guideline about investment in China is "Act Governing Relations between Peoples of the Taiwan Area and the Mainland Area". According to this Act, anyone gets permission by the Ministry of Economic Affairs may make investment, have technology cooperation, engage in business in China or engage in the trade activities between the Taiwan Area and the Mainland Area. Based on the consideration of international treaty, national defense, national security and industry development, the product or business item about the referred investment or technology cooperation are categorized into prohibited and general categories.

The definition about “investment in China” denotes as any of the following activities: establishing a new company or business entity; increasing the capital of an existing local company or business entity; acquiring the equity of, and operating, an existing local company or business entity, but not including the purchase of stock of a listed company; establishing or expanding the business of a branch company or business entity. Investment in China can also be applicable to those investments activities mentioned above made by any Taiwanese company in a third area. So investment in China includes direct investment and indirect investment.

For the purpose of investing in China, the capital carried out of Taiwan shall be in the form of: cash; machinery, equipment and spare parts; raw materials, intermediate products or finished products; technical know-how, patent, trademark right or economic right; or other property in which under the approval of Ministry of Economic Affair.

In order to simplify the administration procedure, the investment not over US$200 thousand may be made through filing. To control capital outflow leakage and reduce enterprise investment risks, the allowed accumulated investment amount or ratio upper limit for investment in China has been set as the following standards:

category	net worth	allowed accumulated investment amount or ratio upper limit for outward investment in China
individual, small and medium enterprise		NT$80 million
capital share issued above NT$80 million enterprise	below NT$5 billion	40% of net worth or NT$80 million which one is higher
	more than NT$5 billion but less than 10 billion	(A). enterprise’s net worth below NT$5 billion : 40% of net worth, (B). 30% on the portion of net worth more than NT$ 5 billion
	more than NT$10 billion	(A). enterprise’s net worth below NT$ 5 billion : 40% of net worth, (B). 30% on the portion of net worth more than NT$ 5 billion but less than 10 billion, (C). 20% on the portion of net worth more than NT$ 10 billion

Basically the investment amounts for any Taiwanese investors who make investment in China cannot exceed the upper limit, but the enterprise uses its earning to expand capital shares or the investment does not over US$200 thousand made through filing do not count into accumulated investment amount. Investors who remit principal or earnings back to Taiwan, those amounts can be subtracted from accumulated investment value.

In order to enlarge the investment scale, a lot of entrepreneurs urge the government to loosen investment upper limit recently. On account of the pursuit of national sustainable development, the government still adopts “active management, effective opening” investment in China policies.

III. Taxation systems on Taiwan outward investment in China

In Taiwan, profit-seeking enterprise income tax is levied base on national principle plus territoriality principle. Profit-seeking enterprise having its head office within Taiwan shall be levied on its total income derived within or without Taiwan. Income tax has been paid on the income derived outside Taiwan such tax paid may be deducted from the amount of tax payable. The foreign income tax deduction shall not exceed the amount of tax which is increased in consequence of inclusion of its income derived from abroad.

Profit-seeking enterprise having its head office without Taiwan but having Taiwan sources income shall be levied profit-seeking enterprise income tax.

Beginning from the year 1998, the integration of personal income tax and profit-seeking enterprise income tax, the net dividend or net surplus earning received by a profit-seeking enterprise organized as a company from its investment in another domestic profit-seeking enterprise shall not be included in its taxable income, and the amount of tax deductible from such income shall be included in the balance in its shareholder deductible tax account. To avoid investment income being double taxed, a company receiving net dividend or net surplus from its investment in another domestic profit-seeking enterprise is not counted into its income.

In order to encourage companies to utilize worldwide resources and set up international operation network, if they establish operation headquarters within Taiwan reaching a specific size and bringing about significant economic benefit like employee numbers and sales revenue amount, their following incomes shall be exempted from profit-seeking enterprise income tax:

1. the income derived from provision of management services or R&D services to its affiliates abroad;
2. the royalty payment received from its affiliates abroad;
3. the investment return and assets disposal profits received under its investments in its affiliates abroad.

Therefore, any profit-seeking enterprise of Taiwan having income derived from China shall pay income tax together with the income derived from Taiwan. The amount of the income tax already paid in China can be deducted from the amount of the income tax payable.

Also, any profit-seeking enterprise of Taiwan permitted by the Ministry of Economic Affairs to make indirect investment in China through a third area includes the investment income in the third area, the investment income derived from the income distributed by the invested company or enterprise in China shall be deemed as the income derived from China. Taxable investment income from a third area refers to the investment income amount distributed by company or enterprise in a third area, and there is no need to separately compute income from sources in China. The amount of income tax paid in China and a third area against the portion of investment income derived from China may be deducted from the amount of the income tax payable. The total amount to be credited may not exceed the increment of the income tax payable computed, after including the income derived from China.

The amount of income tax paid in China and a third area includes the following three parts:

(1) Income tax on dividends has been paid in China by a company or enterprise in a third area got investment income from China.

(2) Income tax as computed according to the following formula has been paid in a third area by a company or enterprise in a third area got investment income from China:

Corporate income tax of the year paid by the company or enterprise in a third area × investment income of the year derived from China ÷ total income of the company or enterprise in a third area for that year.

(3) Investment income of a company or enterprise in a third area for which income tax on dividends has been paid in the third area.

Income tax on dividends has been paid in China and income tax paid in a third area by a company or enterprise in a third area got investment income from China with documents in proof can be deducted from the amount of the income tax payable within the prescribed limits regardless of the year when income tax was paid.

IV. Double taxation issues

China enterprise income tax law categorizes enterprises as resident enterprises and nonresident enterprises. Resident enterprises include those established in accordance with the laws of China within Chinese territory and those established under the laws of another country but actual administration institution is located within China. Nonresident enterprises are those established in accordance with the laws of foreign country whose actual administration institution is located outside the territory of China. A resident enterprise shall pay enterprise income tax on worldwide sources concept. Nonresident enterprise with organizations or establishments within China, pay income tax on China source income as well as income derived from outside China but related to such organizations or establishments. Nonresident enterprise without any organizations or establishments within China, or with organizations or establishments within China but its income is not in fact related to such organizations or establishments, it pay income tax on China source income.

New enterprise income tax law enlarges taxation territory. Under the new law if enterprise was registered in foreign country but actual administration institution is located within China, it will be levied on worldwide income. Actual management institution denotes actually and completely management and control about enterprise's production, personnel, accounting books, properties.

Taiwan income tax act divides enterprise into resident enterprises and nonresident enterprises according to the location of head office within or without Taiwan. Enterprise's head office within Taiwan or subsidiary company in a third area investment in China but has actual administration institution located within China will become double resident enterprise. Owing to taxation territory overlap causes double taxation. That's the point so many Taiwanese enterprises choose to invest in China via a third area like Hong Kong or BVI. Furthermore, to avoid investment in China upper limit amount or ratio and to tax planning reasoning most of enterprises retain their investment earnings in China. Most of countries use foreign tax credit, investment income exemption or sign tax agreement to resolve multinational double taxation problem.

For those enterprises adopt direct investment in China. The income tax burdens in China are 25% enterprise income tax rate plus10% dividend outward remittance withholding rate. The investment income tax burden in Taiwan is 25% profit-seeking enterprise income but 10% dividend income tax levied in China can be deducted from income tax payable.

For those enterprises adopt direct investment in China but establish operation headquarters within Taiwan. The income tax burdens in China are 25% enterprise income tax rate plus 10% dividend outward remittance withholding rate. The investment income is exempted from Taiwanese profit-seeking enterprise income tax but 10% dividend income tax levied in China can be deducted from income tax payable.

For those enterprises via a third area adopt indirect investment in China but establish operation headquarters within Taiwan. The income tax burdens in China are 25% enterprise income tax rate plus 10% dividend outward remittance withholding rate. The investment income is levied according to the tax rate or is exempted in tax heaven. The investment income is exempted from Taiwanese profit-seeking enterprise income tax but 10% dividend income tax levied in China and the income tax paid in a third area can be deducted from income tax payable.

V. Conclusions

Now China is the largest world manufacture factory. Enterprises build their production factory in China. In the near future China will become the largest world consumer markets. Enterprises will establish their operation headquarter in China gradually. In face of this trend, Taiwan government should adjust her investment in China examination criteria like to loosen investment upper limit amount or ratio or examination by classifications. Tax system revise is necessity to harmony with increasing close investment and trade activities with China. Furthermore, to avoid investment double taxation by signing tax agreement with China is the ultimate goal.

References

1. Act Governing Relations between Peoples of the Taiwan Area and the Mainland Area
2. Enforcement Rules for the Act Governing Relations between Peoples of the Taiwan Area and the Mainland Area
3. Enterprise Income tax Law
4. Guide to R.O.C. Tax 2007
5. Income Tax Act
6. Regulations Governing the Approval of Investment or Technical Cooperation in Mainland China
7. Statute for Upgrading Industries

Table 1　Statistics on Taiwan Approved Overseas Chinese and Foreign Investment

Year	Case （unit）	Amount （US$1,000）
1952~1996	8,197	24,721,779
1997	683	4,266,629
1998	1,140	3,738,758
1999	1,689	4,231,403
2000	1,410	4,607,752
2001	1,178	5,128,518
2002	1,142	3,271,749
2003	1,078	3,575,674
2004	1,149	3,952,148
2005	1,131	4,228,068
2006	1,846	1,3969,247
1952~2006	20,043	78,691,729
2007 01~11	1,619	11,900,333

Source: Investment Commission, Ministry of Economic Affairs

Table 2 Taiwan Top 10 Approved Inward Investment country from 1952 to 2007 November

Country	Case (unit)	Share （%）	Amount （US$1,000）	Share （%）
Total	22,080	100.00%	92,829,253.98	100.00%
U.S.A.	3,584	16.23%	18,094,347.96	19.49%
Japan	5,518	24.99%	15,213,037.40	16.39%
Caribbean Sea	3,088	13.99%	15,188,725.79	16.36%
Netherlands	363	1.64%	14,604,172.24	15.73%
Singapore	1,120	5.07%	5,559,314.11	5.99%
U.K.	473	2.14%	4,721,365.38	5.09%
Hong Kong	2,855	12.93%	4,416,327.60	4.76%
Bermuda	103	0.47%	1,955,590.41	2.11%
German	403	1.83%	1,742,048.53	1.88%
Malaysia	695	3.15%	1,624,699.77	1.75%

Source: Investment Commission, Ministry of Economic Affairs

Table 3 Statistics on Taiwan Approved Outward Investment

Year	Case （unit）	Amount （US$1,000）
1952~1996	2,997	12,420,173
1997	759	2,893,826
1998	896	3,296,302
1999	774	3,269,013
2000	1,391	5,077,062
2001	1,387	4,391,654
2002	925	3,370,046
2003	714	3,968,588
2004	658	3,382,022
2005	521	2,447,449
2006	478	4,315,426
1952~2006	11,500	48,831,561
2007 01~11	435	5,126,512

Source: Investment Commission, Ministry of Economic Affairs

Table 4 Taiwan Top 10 Approved Outward Investment country from 1952 to 2007 November

Country	Case (unit)	Share （%）	Amount （US$1,000）	Share （%）
Total	11,935	100.00%	53,958,072.47	100.00%
Caribbean Sea	1,897	15.89%	20,035,109.98	37.13%
U.S.A.	4,885	40.93%	10,130,615.57	18.77%
SINGAPORE	444	3.72%	3,873,029.82	7.18%
Hong Kong	967	8.10%	2,672,125.82	4.95%
Bermuda	99	0.83%	2,511,657.32	4.65%
Thailand	383	3.21%	1,936,735.83	3.59%
Malaysia	306	2.56%	1,708,121.78	3.17%
Vietnam	352	2.95%	1,463,251.07	2.71%
Netherlands	139	1.16%	1,235,744.57	2.29%
Panama	67	0.56%	1,198,918.00	2.22%

Source: Investment Commission, Ministry of Economic Affairs

Table 5 Statistics on Approved Indirect Mainland Investment

Year	Case （unit）	Amount （US$1,000）
1991~1996	11,637	6,873,724
1997*	8,725	4,334,313
1998*	1.284	2,034,621
1999	488	1,252,780
2000	840	2,607,142
2001	1,186	2,784,147
2002*	5,440	6,723,058
2003*	10,105	7,698,784
2004	2,004	6,940,663
2005	1,297	6,006,953
2006	1,090	7,642,335
1991~2006	35,542	54,898,520
2007 01~11	917	8,448,607

Source: Investment Commission, Ministry of Economic Affairs

∗including supplementary approved cases and amounts

Table 6 Investment from Taiwan from 1989 to 2007 Nov.

Year	Number of Projects			Realized FDI Value (US$10,000)		
	Taiwan	National Total	Share （%）	Taiwan	National Total	Share （%）
1989	539	5779	9.33	15,479	339,257	4.56
1990	1,103	7,273	14.17	22,240	348,711	6.38
1991	1,735	12,978	13.37	46,641	436,634	10.68
1992	6,430	48,764	13.19	105,050	1,100,751	9.54
1993	10,948	83,437	13.12	313,859	2,751,495	11.41
1994	6,247	47,549	13.14	339,104	3,376,650	10.04
1995	4,847	37,011	13.10	316,155	3,752,053	8.43
1996	3,184	24,556	12.97	347,484	4,172,552	8.33
1997	3,014	21,001	14.35	328,939,	4,525,704	7.27
1998	2,970	19,799	15.00	291,521	4,546,275	6.41
1999	2,499	16,918	14.77	259,870	4,031,871	6.45
2000	3,108	22,347	13.91	229,628	4,071,481	5.64
2001	4,214	26,140	16.12	297,994	4,687,759	6.36
2002	4,853	34,171	14.20	397,064	5,274,286	7.53
2003	4,495	41,081	10.94	337,724	5,350,467	7.35
2004	4,002	43,664	9.07	311,749	6,062,998	5.14
2005	3,907	44,019	8.88	215,171	7,240,569	2.97
2006	3,752	41,485	9.04	213,583	6,946,761	3.07
2007/01~11	2,993	34,419	8.70	143,426	6,167,413	2.33

source: Department of Foreign Investment Administration ,Ministry of Commerce

Table 7　Top 15 Investors in China as of 2006

Country	No. of Projects	Share （%）	Realized FDI Value（US$100 million）	Share （%）
Total	594,445	100	7,039.74	100
Hong Kong	269,555	45.35	2,797.55	39.74
Japan	37,714	6.34	579.73	8.24
U.S.A.	16,616	2.80	571.64	8.12
Virgin Islands	52,211	8.78	539.55	7.66
Taiwan	71,847	12.09	438.93	6.24
R.O.K.	43,130	7.26	349.99	4.97
Singapore	15,556	2.62	300.04	4.26
U.K.	5,359	0.90	139.22	1.98
Germany	5,338	0.90	134.18	1.91
Cayman Islands	1,843	0.31	107.55	1.53
France	3,271	0.55	78.02	1.11
Netherlands	1,949	0.33	77.59	1.10
Macau	4,358	0.73	75.13	1.07
West Samoa	10,697	1.80	69.40	0.99
Canada	9,788	1.65	54.14	0.77
Others	45,213	7.60	727.09	10.33

source:　Department of Foreign Investment Administration, Ministry of Commerce