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## OUTCOME OF PROCEEDINGS

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From: General Secretariat of the Council  
To: Code of Conduct Group (Business Taxation)  
Subject: Taiwan's Free Trade Zone regime, including the International Airport Park  
Development regime (TW001)  
– Final description and assessment

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## ROLLBACK REVIEW PROCESS (JANUARY 2019)

The amendments to Article 29 of the Act for the Establishment and Management of Free Trade Zones and to Article 35 of the International Airport Park Development Act were submitted to Taiwan's Legislative Yuan on 11 October 2018 and adopted on 28 December 2018 for entry into force on 1 January 2019. Taiwan has amended both articles to remove the ring-fencing features, namely the reference to foreign profit seeking enterprises and the exemption ceiling of 10% in domestic sales with grandfathering until 31 December 2021.

The Code of Conduct Group meeting of 30 January 2019 approved the rollback of the regime. This conclusion was endorsed by the ECOFIN Council on 12 March 2019.

*Annex 1: Assessment of the old TW001 regime in 2017 (standstill review)*

*Annex 2: Informal English translation of the final legislation.*

**Assessment of the old TW001 regime in 2017 (standstill)**

Category:

Special economic zones

**a. Description**

Under the Act for the Establishment and Management of Free-trade-zones, a foreign company or its branch in Taiwan which applies for the establishment of, or assigns free trade zone enterprises to store and/or perform simple processing of goods in a free trade zone and sell the goods within or outside Taiwan, is exempted from corporate income tax.

However, in the event that the annual domestic sales exceed 10% of the total annual domestic and foreign sales of the goods distributed from the free trade zone, the portion in excess is not exempted from corporate income tax.

There are also indirect tax incentives in free trade zones, for example, the trading of goods and services within the free trade zones is exempted from customs duty, commodity tax and VAT.

Source: IBFD:

[http://online.ibfd.org/kbase/#topic=doc&url=%252Fcollections%252Fgtha%252Fhtml%252Fgtha\\_tw\\_s\\_001.html&WT.z\\_nav=outline&colid=4915&hash=gtha\\_tw\\_s\\_1.7](http://online.ibfd.org/kbase/#topic=doc&url=%252Fcollections%252Fgtha%252Fhtml%252Fgtha_tw_s_001.html&WT.z_nav=outline&colid=4915&hash=gtha_tw_s_1.7)

**b. Preferential (lower taxation than normal):**

Exempted from corporate income tax

**c. Possible concern (ring fenced):**

In the event that the annual domestic sales exceed 10% of the total annual domestic and foreign sales of the goods distributed from the free trade zone, the portion in excess is not exempted from corporate income tax.

#### d. Assessment :

	1a	1b	2a	2b	3	4	5
Taiwan – Free Trade Zone (TW001)	V	?	X	?	X	?	X

V = harmful

X = not harmful

#### Explanation

##### **Significantly lower level of taxation:**

The general flat tax rate (“profit –seeking enterprise income tax”) in Taiwan is 17%. The Act for the establishment and management of the Free Trade Zones, grants an exemption for a foreign profit-seeking enterprise which stores, delivers its goods, and/or performs simple processing in free trade zone. In the event that the annual domestic sales exceed 10% of the total sales (i.e. domestic as well as foreign sales), the exceeded portion shall not be exempted from business income tax. The measure provides for a significantly lower level of taxation. It is therefore potentially harmful within the meaning of paragraph A of the Code.

##### **Criterion 1:**

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a concerns the de jure application of the measure.

According to article 29 of the Act for the establishment and management of the Free Trade Zones, the exemption from business income tax is provided only for foreign for-profit businesses or their branches in the Republic of China (“ROC”) that apply for the establishment of free-trade- zone enterprises to store, and/or perform simple processing in the zone and sell the products in and out of Taiwan. The provision restricts the benefits to non- resident taxpayers.

1b) Criterion 1b is used to complement the assessment under criterion 1a which only looks at the literal interpretation of the measure. It takes account of the de facto effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b.

The relevant data and information are lacking.

## Criterion 2

As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. de jure interpretation and de facto analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

2a) What has been written under criterion 1a often applies analogously to criterion 2a.

According to article 29 of the Act for the establishment and management of the Free Trade Zones, companies allowed to operate in the Free Trade Zone are exempted from business income tax for both foreign sales and domestic sales. Domestic sales shall not exceed a 10% threshold; in this case, the portion of profits exceeding the threshold is not exempted. The benefit affects the national tax base.

2b) On the basis of the explanations provided above and the marking under criterion 1b, the evaluation of criterion 2b often follows the same reasoning.

The relevant data and information are lacking.

## Criterion 3

According to the standard practice for the evaluation of a measure against criterion 3, a measure is found harmful under this criterion if there are no specific requirements with regard to real economic activities and notably any requirement with respect to employment obligations.

The benefit of the total or partial exemption from business income tax is granted whether the free trade zone company stores, and/or perform simple processing of goods and sells them to the domestic or foreign market. Article 3, paragraph 2 of the Act states that the definition of “free trade enterprise” refers to those which have been approved to engage in trading, warehousing, logistics, collecting, distributing (cargo of) containers, transiting, trans-shipment, forwarding, customs clearance, assembling, sorting, packaging, repairing, fabricating, processing, manufacturing, examining, testing, displaying or technological services.

Due to the kind and nature of activities that give rise to the exemption, the application of this measure explicitly requires productive (or active) investment and the qualifying activities do not include any ‘highly mobile’ activities (intra-group service, co-ordination centre, financial services activities etc.).

Moreover, there is an express requirement of employment in article 10 of the Act, which states that the number of domestic employees employed by a free trade zone enterprise shall not be lower than 60% of that of its total employees.

#### **Criterion 4**

Taiwan has transfer pricing rules requiring transactions between related parties to be conducted at arm's length. It is unclear how the taxable base is calculated for the portion of the profits exceeding the 10% threshold.

#### **Criterion 5**

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent.

According to Article 13 of the Act, an enterprise applying to establish and operate within a free trade zone shall submit a business operation plan, the written operation procedures in connection with good control, custom clearance and accounting operations together with relevant required documents.

The measure is fully set out and published in the relevant legislation and the practice should not involve any administrative discretion.

#### **Overall assessment**

In light of the assessment made under all Code criteria, the regime is considered as overall harmful from a Code of Conduct point of view.

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**Informal English translation of the final legislation**

**Article 29 of the Act for the Establishment and Management of Free Trade Zones**

Profit-seeking enterprises, which engage only in preliminary or auxiliary business activities in the Republic of China (ROC) by the enterprises themselves or delegate free-trade-zone (FTZ) enterprises to purchase, import, store, or deliver products in FTZs, and are reviewed and approved by the FTZ management authority shall be exempted from profit-seeking enterprise income tax on the income from selling such products.

When profit-seeking enterprises from foreign countries, mainland China, Hong Kong, or Macau without a fixed place of business in the ROC purvey commodities certified by a recognized international metal futures exchange and ratified by the authority (MOTC), or the commodities of the same tariff number as those described above, and when the commodities are stored in places of FTZ enterprises approved by the FTZ management authority, the income from sales to domestic and/or overseas customers shall be exempted from profit-seeking enterprise income tax without the need to apply for such tax exemption, and the enterprises are exempted from filing an income tax return for such income in accordance with the Income Tax Act.

The regulations governing the scope of preliminary or auxiliary business activities, purchase, import, storage, or delivery of products, the approved application period as stipulated in paragraph 1; the application scope and specific conditions, authorized and approved authorities as stipulated in paragraph 2; as well as application procedures, approval, abolishment and other relevant requirements specified in both the preceding two paragraphs shall be prescribed by the competent authority (MOTC) in consultation with the Ministry of Finance.

The profit-seeking enterprise income tax exemption stipulated in paragraph 1 and paragraph 2 shall remain in effect until 31 December 2042.

Paragraph 1 to paragraph 3 amended on 28 December 2018 shall enter into force from the profit-seeking enterprise income tax return for the year 2019.

For cases which have been approved in accordance with paragraph 1 prior to the amended articles on 28 December 2018, the approved application period shall end by 31 December 2021.

For cases which have been applied but not been approved prior to the amended articles on 28 December 2018, the income tax exemption for the year 2018 and previous years shall be applicable to paragraph 1 prior to the promulgation; the income tax exemption for the year 2019 and following years shall be applicable to paragraph 1 after the promulgation.

## Article 35 of the International Airport Park Development Act

Profit-seeking enterprises, which engage only in preliminary or auxiliary business activities in the Republic of China (ROC) by the enterprises themselves or delegate free-trade-zone (FTZ) enterprises in Airport Park to purchase, import, store, or deliver products in FTZs and are reviewed and approved by the FTZ management authority shall be exempted from profit-seeking enterprise income tax on the income from selling such products.

The regulations governing the scope of preliminary or auxiliary business activities; purchase, import, storage, or delivery of products; application conditions, the approved application period, application procedures, approval, abolishment, and other relevant requirements specified in the preceding paragraph shall be prescribed by the competent authority (MOTC) in consultation with the Ministry of Finance.

The profit-seeking enterprise income tax exemption stipulated in paragraph 1 of shall remain in effect until 31 December 2042.

Paragraph 1 and paragraph 2 amended on 28 December 2018 shall enter into force from the profit-seeking enterprise income tax return for the year 2019.

For cases which have been approved in accordance with paragraph 1 prior to the amended articles on 28 December 2018, the approved application period shall end by 31 December 2021.

For cases which have been applied but not been approved prior to the amended articles on 28 December 2018, the income tax exemption for the year 2018 and previous years shall be applicable to paragraph 1 prior to the promulgation; the income tax exemption for the year 2019 and following years shall be applicable to paragraph 1 after the promulgation.