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GLOBAL TRANSFER PRICING SERVICES

# Global Transfer Pricing Review

Taiwan

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TAX



# Taiwan



## KPMG observation

Beginning with the 2005 tax year, companies have been required to prepare transfer pricing reports or substitute reports to document their compliance with arm's length principles.

In the past 2 to 3 years, several measures have been taken by Taiwan tax authorities to enhance the effectiveness and efficiency of transfer pricing audits. Generally, there are two types of tax audits that involve transfer pricing:

### 1. General tax audit:

When tax officers conduct income tax return assessments, they sometimes request transfer pricing reports for compliance checks and/or review of potential transfer pricing issues. If the tax officers disagree with the transfer pricing results and propose transfer pricing adjustments, the final assessment amount will be negotiated together with other tax adjustment items. However, the assessment will not be labelled a transfer pricing assessment to avoid having to submit assessment reports to the Ministry of Finance (MOF) for review and approval.

### 2. Special transfer pricing audit:

For companies selected for a special transfer pricing audit, Taiwan tax offices will form a team of three or four senior tax officers to conduct the audit, and set a very high tax assessment goal. The audit procedures are more intensive and the timeframe is much longer than a general tax audit, spanning 1 to 2 years. The tax officers tend to form very strong viewpoints, and it can be difficult to persuade them to accept the company's explanations and transfer pricing positions. The tax offices must submit their assessment reports to the MOF for review and approval.

Recently, the taxation bureaus in Taipei and northern Taiwan have set up specialized transfer pricing teams. While it is unclear how this specialized transfer pricing team will operate, based on our preliminary understanding, their mission will at least cover the following:

- negotiation of Advance Pricing Arrangements (APAs);
- selection of transfer pricing focused audit targets; and
- conduct of transfer pricing focused audits.

Centralizing the above-mentioned tasks at these specialized transfer pricing focus teams will be helpful for expediting the accumulation of transfer pricing audit experience and enhancement of technical knowledge and skills within the tax authorities. It is foreseeable transfer pricing audit activity in Taipei and the northern Taiwan region will be intensified significantly, and that the APA negotiation process could be expedited going forward.

## Basic information

### Tax authority name

Ministry of Finance (MOF) and the district offices of the National Tax Administration (NTA).

### Citation for transfer pricing rules

Article 43-1 of the Income Tax Act and Regulations Governing Assessment of Profit-Seeking Enterprise Income Tax on Non-Arm's Length Transfer Pricing (Taiwan Transfer Pricing Assessment Rules).

### Effective date of transfer pricing rules

28 December 2004.

### What is the relationship threshold for transfer pricing rules to apply between parties?

In addition to a 20 percent ownership, the MOF has adopted the 'substantive management and control' and 'material influence' concepts in defining a related party relationship.

### What is the statute of limitations on assessment of transfer pricing adjustments?

Five years from the tax return filing date if the return is filed in a timely fashion. In situations where a taxpayer fails to file the annual tax return within the statutory deadline or is involved in tax fraud or tax avoidance, the statute of limitations will be extended to 7 years.

## Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. The taxpayer must disclose information about controlled transactions on forms filed with income tax returns.

### What types of transfer pricing information must be disclosed?

The types of information to be disclosed include, but are not limited to:

- legal structure
- detailed information on related parties
- controlled transaction types and respective amounts

- whether the taxpayer has signed APAs with tax authorities in Taiwan or foreign jurisdictions and the relevant information
- whether a transfer pricing study has been prepared.

### What are the consequences of failure to prepare or submit disclosures?

There is no penalty involved, but if uncovered by the tax offices, it will undermine the credibility of taxpayers.

## Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

Yes, for certain transactions which exceed the safe harbor threshold.

In general, taxpayers must, at the time of filing annual income tax returns, maintain an extensive list of documentation and a transfer pricing study to support the controlled transactions. However, the MOF prescribed a safe harbor rule (the total annual turnover of a taxpayer does not exceed 300 million New Taiwan dollars (NTD) or its annual aggregate amount of controlled transactions does not exceed NTD200 million), to alleviate taxpayers' burden and compliance cost. If the taxpayer meets the safe harbor threshold, it may provide 'other supporting documentation' as a substitute report that sufficiently establish the arm's length nature of the controlled transactions.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

By reviewing the transfer pricing disclosure forms, tax officers would easily know whether transfer pricing reports are prepared. If a taxpayer fails to provide a transfer pricing report upon the tax authority's request, the applicable penalty would be NTD3,000 to NTD30,000 according to Article 33 of Transfer Pricing Assessment Rules. The amount of the penalty may seem immaterial, but there are other consequences of not preparing a report.

During a transfer pricing audit, if the taxpayer does not provide information as requested by the tax authorities (e.g. transfer pricing report or substitute report), the tax authorities could make an assessment based on information gathered themselves. If the tax authorities cannot gather relevant information, they can determine an assessment by applying the 'Standard Profit Margin of the Same Industry'.

Furthermore, if the assessment results in a transfer pricing adjustment, where the taxpayer fails to provide a transfer pricing report or other documentation, a penalty up to 200 percent of the underpaid tax amount will be imposed under Article 34 of Transfer Pricing Assessment Rules.

Thus, by not preparing a transfer pricing report or substitute report, a taxpayer could increase the chance of being selected for audit. It could also increase the difficulty of defending its transfer pricing position. If there is a transfer pricing adjustment, the taxpayer would face additional penalties.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

The transfer pricing study must be prepared contemporaneously with the tax return and must be submitted within one month of receipt of a notice of investigation sent by the tax authorities. In special circumstances, taxpayers are also given the option of a one-time extension of an additional month.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

No. Taiwan Transfer Pricing Assessment Rules have listed out the following minimum required items to be included in the transfer pricing study:

- industry and economic condition analysis
- function and risk analysis of each entity engaged in the controlled transactions
- application of arm's length principles set forth in Article Seven of the Regulations Governing Assessment of Profit-Seeking Enterprise Income Tax on Non-Arm's Length Transfer Pricing

- identity of and information on comparable companies selected
- comparability analysis for application of best method rule
- a best method analysis, including a description of the transfer pricing methods selected, the reasons for selection, and description of other methods considered and the reason(s) they were not selected
- the transfer pricing methods adopted by other entities engaged in the controlled transactions and relevant information
- the arm's length results of applying the best method, including relevant data of comparables, adjustments made to eliminate differences with comparables, assumptions made, arm's length range derived, conclusion on arm's length nature, adjustments made according to the arm's length range.

**Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?**

No.

## Transfer pricing methods

**Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?**

Yes, with some exceptions. Instead of the transactional net margin method (TNMM), Taiwan Transfer Pricing Assessment Rules adopt the comparable profits method, which is very similar to the TNMM outlined in the OECD Guidelines. Advance approval must be obtained from the MOF for applying unspecified methods.

**Is there a priority among the acceptable methods?**

No hierarchical priority among the acceptable methods.

**If there is no priority of methods, is there a "best method" rule?**

Yes.

## Transfer pricing audit and penalties

**When the tax authority requests a taxpayer's transfer pricing documentation, how long does the taxpayer have to submit its documentation?**

Upon request, taxpayers are required to submit the documentation within 1 month from the date of receipt of notification. In special circumstances, taxpayers are also given the option of a one-time extension of an additional month.

**If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?**

Yes, the taxpayer has the option to resolve disputes through the administration remedy procedure.

**If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?**

Yes. If the transfer pricing audit results in income adjustments and assessments, a penalty of up to 200 percent of the underpaid tax amount (where the taxpayer has filed their tax returns on time) will be imposed under any one of the following situations:

- where the reported controlled transaction prices are 200 percent or more, or 50 percent or less of the arm's length prices as assessed by the tax authority
- where the income adjustment assessed by the tax authority reaches 10 percent of the taxpayer's assessed annual income and three percent of the assessed annual net sales
- where the taxpayer fails to provide a transfer pricing study and cannot provide other documentation to prove that its transfer price is at arm's length
- other situations where the tax authority finds evidence of underreporting income and the amount underreported is considered significant.

**To what extent are transfer pricing penalties enforced?**

In practice, penalties are rarely enforced because most audits are settled via negotiation.

**What defences are available with respect to penalties?**

There is no defense to any of the penalties, other than to defend against the underlying adjustment.

**What trends are being observed currently?**

The tax authorities are currently stepping up the pace of transfer pricing audits as a way to actively seek additional tax revenue. As a result, special transfer pricing audit teams have been formed by the tax authorities to conduct more comprehensive and in-depth transfer pricing audits than in the past. The number of cases selected has increased along with the intensity of the tax authorities' review.

We have observed that under audit, the tax authorities tend to question the aggregate testing approach and request separate testing for different controlled transactions. Moreover, the tax authorities have focused more on intangible property and intra-group funding arrangements, especially cash-pooling and intra-group guarantee arrangements.

## Special considerations

**Are secret comparables used by tax authorities?**

Based on our observation of the current practice, secret comparables are not used by tax authorities.

**Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?**

Yes. If the tested party is a company in Taiwan, the tax authorities prefer to apply local comparables. However, foreign comparables are acceptable if the local comparables are insufficient.

### Do tax authorities have requirements or preferences regarding databases for comparables?

There are no specific requirements regarding which database should be applied.

### What level of interaction do tax authorities have with customs authorities?

Currently, low.

### Are management fees deductible?

Generally speaking, expenses will be deductible for Taiwan income tax purposes only if they are necessary and relevant to a business' operation. In practice, taxpayers bear a heavy burden of proof to justify to the tax authorities that management fees are necessary and relevant to a business's operation.

### Are management fees subject to withholding?

From the offshore entity's perspective, the management fee it receives will most likely be deemed as Taiwan-sourced income. Thus, it will generally be subject to 20 percent withholding tax at source unless mitigating measures under domestic law or tax treaty are available.

### Are year-end transfer pricing adjustments permitted?

Yes, but in general only adjustments increasing taxable income. According to the Taiwan Transfer Pricing Assessment Rules, if the results of a controlled transaction fall outside the arm's length range, the current year result shall be adjusted based on the median of the range. Nonetheless, no transfer pricing adjustment is allowed if it results in a decrease in Taiwan tax liability.

The MOF once issued a private ruling to a company allowing it to make a one-time downward transfer pricing adjustment before closing the financial accounts, provided certain conditions were met. Other companies who wish to make

downward transfer pricing adjustments should apply for a specific pre-approval ruling with the MOF based on their own facts and circumstances. The application process is expected to be lengthy and extensive supporting information will be required.

### Other unique attributes?

None.

## Other recent developments

The MOF has proposed to enact a controlled foreign corporation (CFC) rule effective from 2015.

Moreover, intensive discussions have been undertaken between the governments of Taiwan and China to develop possible solutions for mitigating cross-strait double taxation with significant progress likely to be achieved in the near future.

## Tax treaty/double tax resolution

### What is the extent of the double tax treaty network?

Minimal.

### If extensive, is the competent authority effective in obtaining double tax relief?

No experience.

### When may a taxpayer submit an adjustment to competent authority?

Based on each treaty's specific rules.

### May a taxpayer go to competent authority before paying tax?

Yes.

## Advance pricing agreements

### What APA options are available, if any?

Unilateral, bilateral, and multilateral.

### Is there a filing fee for APAs?

No.

### Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

No.

### Please provide some information on how successful the APA program is and whether there are any known difficulties?

Taiwan does have an APA program but not many are concluded due to lack of tax authority resources.

## Language

### In which language or languages can documentation be filed?

In general, all the required documentation is to be provided in Chinese. However, to alleviate the taxpayers' compliance cost, English language documentation may be acceptable if approved by the tax authorities.

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Designed by Evalueserve.

Publication name: Global Transfer Pricing Review

Publication number: 131196

Publication date: June 2014