needed is a management system that recognizes commercial reality as well as consumer needs, while balancing political and media pressure. Not an easy assignment, but one that will win government widespread respect if carried out effectively.

TAX

As the tax environment is one of the vital factors in attracting foreign investment and building Taiwan's economic competitiveness, the Committee urges continued governmental efforts to undertake tax reforms to help improve the investment climate. The Committee appreciates the government's willingness over the past year to listen to the voice of the foreign business community and to help resolve issues as they arise. The Ministry of Finance (MOF), for example, issued several useful rulings to clarify the tax issues arising from M&A transactions.

In this position paper, the Committee would like to raise the following specific issues that require the immediate attention of the MOF. Some of them are new; others were raised in past years but are not yet resolved. We hope the MOF will address them in the months ahead. The Committee looks forward to continued cooperation with the MOF to foster a tax system that is more in line with international tax practice and makes Taiwan an even more attractive and competitive business environment.

Issue 1: Clarify the scope of Taiwan-source income and allow offshore businesses to file tax returns for their Taiwan-source "other income."

The Committee addressed this issue in the 2008 *White Paper*. Under current Taiwan tax practice, the scope of Taiwan-source income is very broad, classifying payments made to offshore entities as Taiwan-source "other income" even if those payments relate to services performed entirely offshore. The Committee urges the MOF to clarify the scope of Taiwan-source income by providing a precise and clear interpretation with no gray areas, so as to facilitate tax compliance. Transfer-pricing payments made by Taiwan entities with full documentation supporting the arm's-length basis of the transactions should not be considered Taiwan-source income, nor should they be subject to Taiwan income tax. Moreover, besides the 20% withholding tax mechanism, we suggest that a Taiwan tax reporting/filing system be available for offshore entities if they choose to use it. In this way, offshore businesses that are considered to have Taiwan-source "other income" or "business profits" can have the opportunity to claim their business costs/expenses on the tax return, with only the profits subject to Taiwan income tax. The Committee understands that the Tax Agency outsourced a study of this matter, which agrees with our position that if the offshore business is considered to have business profits in Taiwan, it can file a tax return and claim costs/expenses. We would urge the MOF to adopt this suggestion and provide a timeframe for its implementation.

Issue 2: Solve the interpretation gap between government agencies.

For a long time, various government agencies have held inconsistent opinions on tax issues, leading to continuing difficulties in resolving tax disputes. Following are some examples:

1. ***Differing interpretations of "standard software" between the MOF and the tax office.*** According to the Income Tax Act (ITA), revenue from licensing software should be treated as Taiwan-source income. When the licensor is a foreign company without a fixed place of business or a business agent in Taiwan, the licensee should withhold 20% income tax upon paying the software licensing fee to the licensor. However, according to MOF Ruling No. 09604520730 dated April 9, 2007, revenue generated by a foreign company from licensing standard software to a Taiwan licensee should be treated as revenue from international sales, and thus the Taiwan licensee need not withhold income tax upon paying the licensing fee to the foreign licensor. This tax ruling also defines "standard software" as non-customized software that is available to customers in general and that customers may not reproduce, modify, resell, or publicly display.

   When foreign licensors have filed applications seeking the tax authorities' confirmation of the applicability of that tax ruling, however, the tax office has either requested submission of a large number of supporting documents without giving a clear answer, or has disallowed the application for a tax ruling based on its own broad interpretation of the criteria. In a case where the licensee subscribed for 10,000 copies of a particular software, for example, instead of shipping 10,000 copies the foreign licensor shipped one copy and gave permission for the licensee to reproduce 9,999 copies on the licensee's premises. In another case where the foreign licensor shipped 10,000 copies of a software product to the licensee, it granted the licensee the right to reproduce the software to the extent of replacing any copies that were damaged during shipment. In both cases, the tax authorities argued that the said tax ruling should not apply because the licensee had the right to reproduce.

   The definition of "standard software" in the tax ruling is clear, but the tax authorities' expansion of the interpretation has caused arguments between them and foreign licensors. The Committee urges the tax authorities to engage in full communication with the MOF on this issue.

2. ***Differing interpretations between the Industrial Development Bureau (IDB) and the tax office regarding the R&D investment tax credit and royalty exemption.***
   a. R&D investment credit. Despite the "examination rule" or guideline permitting the tax office to grant an investment credit for R&D activity performed, in practice the tax office takes a narrow view of the

matter. If there is no patent right associated with the R&D, the tax office will not ask the IDB to check whether R&D activity occurred but will simply deny the claim. In most such cases, the IDB in fact recognized the R&D activity; the tax office, however, did not refer to the IDB's findings before disallowing the taxpayer's claim for the R&D investment tax credit. In some cases the tax office agreed during the reexamination stage that there was R&D activity, but then allowed only 50% of the investment tax credit as a compromise. We urge the tax office to communicate with the IDB and adjust its policy toward R&D investment tax credit claims.

b. Royalty exemption. The ITA enforcement rules stipulate that a foreign company has to obtain the tax office's approval after it receives the IDB's authorization for royalty exemption under Article 4, Item 21 of the Act. But when a foreign company files an application to the tax office for its approval, the tax office generally asks the company to prove that the royalty payment it received from the Taiwanese company is equivalent to the economic benefit that the Taiwanese company obtained. This excessive requirement strains the spirit of the royalty exemption. The Committee suggests that the tax office reach agreement with the IDB to respect its authorization in royalty exemption cases, or else identify in advance all documents needed for the royalty exemption application.

3. ***Difficulties in claiming tax treaty benefits.*** The Committee also addressed this issue in the 2008 *White Paper.* As previously explained, the fundamental objective of a tax treaty is to promote mutual and reciprocal preferential tax treatment for the tax residents of the treaty jurisdictions. In Taiwan, claiming business profit exemptions requires an advance approval process that is generally not found in other treaty jurisdictions. Further, this advance approval requirement often imposes an extra administrative burden on the residents of treaty jurisdictions to collect and prepare supporting documents for application filing purposes. In addition, different and even contradictory views are often voiced by individual tax administrators as to whether the applicant is qualified under the tax treaty, for example regarding the threshold for creation of a Permanent Establishment. As a result, the tax administrators often change the definition of an item of business profit to "royalty" or "other income." The benefits granted under the treaties may consequently be diminished or even denied. The Committee understands that the MOF is aware of this issue and is drafting a detailed guideline. The Committee urges the MOF to gather further public comments before finalizing the guideline, to ensure that the draft takes all relevant considerations into account.

Issue 3: Solve the double-taxation issue regarding employer's payment of expatriates' income tax.

Under MOF Ruling No. 09704042610 dated September 3, 2008, starting from January 1, 2009, income tax that the employer paid on behalf of expatriate employees is considered to be a donation from the employer and therefore subject to income tax as the expatriate's other income. The September 3, 2008 Ruling also mentions that the employer cannot treat such individual income tax payment as its expense. The Committee suggests that since the expatriate employees have to include such payment as their taxable income, the tax office should allow the employers to claim such payment as expense.

In addition, the September 3, 2008 Ruling creates a double-taxation issue as well as a tax compliance problem. For example, if the employer pays $100 tax for the expatriate's 2009 income tax return in 2010, the $100 will be the expatriate's other income – and the $20 tax resulting from the $100 should be included in the expatriate's 2010 income tax return. That $20 tax paid in 2011, if regarded as the expatriate's 2011 income, would then create another tax payable, and such tax payable would generate another tax payable, leading to an endless tax filing problem for the expatriate. We believe that it was not the MOF's intention when issuing the September 3, 2008 Ruling to create such a tax compliance problem. The Committee suggests that after due consideration, the MOF issue another ruling as a remedy. For example, it could be stated that when the expatriate leaves Taiwan, income tax paid by the employer need not be included in the expatriate's income for the year of departure.

Issue 4: Clarify the definition of "place of using the service" under the VAT and Non-VAT Act.

On February 29, 2008, the National Tax Administration of Taipei issued a ruling to the Taiwan Securities Association on the business tax issue that arises when a Taiwan securities house pays commission or service charges to an offshore securities brokerage firm on behalf of its clients for a foreign securities transaction. Although the offshore securities brokerage firm renders the service outside Taiwan, the ruling states that the service charge that local securities house pays to the offshore securities brokerage firm on behalf of its local clients will be subject to business tax. The stated rationale is that the user of the service (the Taiwan securities house) is located in Taiwan, and thus the place for use of the service is in Taiwan. Under the Taiwan VAT and Non-VAT Act (VNVA), service rendered or used in Taiwan – defined as the sale of service in Taiwan – should be subject to business tax. But in the case cited above, the service is not rendered or used in Taiwan. There should thus be no business tax issue (and the Taiwan securities house should only have to pay 2% GBRT on the gross service charge it receives from the clients). The tax office regards the service as used in Taiwan simply because the user is in Taiwan, but that interpretation is mistaking the location of the service user for the place where

the service is rendered or used.

We understand that the Tax Reform Committee (TRC) is reviewing this issue and that the preliminary result of its outsourced study has been announced. That study suggests that the Taiwan securities house only has to pay 2% GBRT on the net service fee it collects from the transaction. In addition, the study concludes that the purchase of service from the offshore securities brokerage should also be subject to 2% GBRT, instead of 5% VAT. The study recommends that this should be dealt with by amendment of Article 36 of the VNVA. Although this solution eliminates the double-taxation issue, the interpretation on which it is based seems unreasonable.

We request that the MOF reverse its stance and accept that the location of the service user is not necessarily identical to the place of rendering or using the service.

Issue 5: Exercise caution regarding the taxation of derivatives.

The Committee appreciates that the TRC has considered the question of taxation on derivatives. For the sake of simplicity, consistency, and equity in the tax system, the TRC resolved that a flat 10% tax rate should be imposed on derivatives and that the Legislative Yuan should enact appropriate legislation to implement it. At a time when Taiwan is seeking to encourage innovation and diversification in its financial products, however, imposing a tax on derivatives may restrain financial market development.

Even if taxation of derivatives is deemed necessary, the MOF should consider ensuring that the taxation is more in line with international trends. As the nature of the derivatives is complicated and the product may be linked to several other financial products, the MOF should set a clear definition of what constitutes a derivative and be aware that the real income derived from the derivatives is the "spread." The Committee urges the MOF to gather further public comments before finalizing the taxation rule, so as to ensure that the draft takes all relevant considerations into account.

Issue 6: Reconsider the decision to include Taiwan individuals' overseas income in AMT calculation.

The Executive Yuan announced on September 15, 2008 that Taiwan individuals must include offshore income in their AMT calculation starting from January 1, 2010. The market for offshore mutual funds has already been feeling the impact, as many local investors have sought to reduce their holdings – or shift them into unregistered underground channels – with an eye to avoiding the prospect of future taxation. The unintended consequence of the new government policy may therefore be to deter Taiwan consumers from taking advantage of attractive investment opportunities and in fact exposing them to greater risk. The policy may also stifle the growth of Taiwan's rapidly developing asset-management sector and seriously set back Taiwan's efforts to establish itself as a dynamic financial market within the Asia Pacific region. By discouraging foreign executives from taking up residence in Taiwan, it would have the impact of making this market even less competitive.

The Committee has learned that the Executive Yuan plans to discuss whether the decision to levy AMT on individuals' overseas income starting in 2010 should be revoked. We urge the government to carefully consider the enormous negative effects that continuing the current policy is certain to have.

TECHNOLOGY

The high-tech industry has been the key driver for Taiwan's economic growth for the past several decades, but during periods of economic downturn, it is also likely to be the hardest hit. The Committee recognizes that the government is taking initiatives to seek remedies for the high-tech industry during the current recession. We encourage the government to look for innovative approaches in its economic stimulus package that can not only re-energize Taiwan's high-tech sector but also improve public services such as healthcare and education.

The Committee would also like to draw the government's attention to the lack of a regulatory policy agency for the internet industry. Considering the dynamic changes and developments happening in that industry every day, it is crucial that the government dedicate sufficient attention and resources to address the issues of greatest concern to the internet industry.

In line with its dedication to promoting the development and adoption of world-class technology to foster Taiwan's economic growth and prosperity, the Committee looks forward to discussing the issues below with the relevant government agencies and to assisting the government to identify possible solutions.

Issue 1: Seek innovative ways to stimulate economic growth while also improving public services in healthcare and education.

Recent reports by Connected Nation and the Information Technology and Innovations Foundation (ITIF) have shown that the use of technologies to improve public services such as healthcare and education can contribute significantly to social welfare and economic value. Given the maturity of Taiwan's broadband infrastructure, the effective use of technology in these public-services areas could also bring more business opportunities to the country's information technology industry. Besides opportunities in the local consumption of hardware devices, software applications, solutions, and services, successful implementation of technology in Taiwan could also generate substantial business overseas, as governments around the world are currently looking for ways to stimulate their domestic economies.

Healthcare

Connected Nation recently reported that a 7% increase in