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NEWSLETTER

Latest Changes to the *Statute for Industrial Innovation*

In an effort to address recent geopolitical tension, as well as the reorganization of the global supply chain, and reinforce Taiwan's key position at the top of the technology industry, the Legislative Yuan passed the **Taiwan Chips Act of the *Statute for Industrial Innovation Article Amendments*** on January 7th 2023 (added Article 10-2, Amended Article 72) which provides tax incentives for investments in both forward-looking innovative R&D and advanced manufacturing processes as to encourage investment from high-tech companies. The amended articles shall be effective from January 1, 2023 to December 31, 2029, a total of seven years. With reference to the Legislative Yuan's announcement, legislative reasons and the May 1st, 2023 notice of the "Regulations Governing Application of Tax Credits for Corporate in Forward-Looking Innovative R&D and Advanced Manufacturing Processes Expenditures Draft" (hereinafter referred to as the Sub-law Draft), the key takeaways from the recent Amendments are summarized below:

I. Articles Added to the *Statute for Industrial Innovation* (hereinafter referred to as the Statute)

1. Article 10-2

To strengthen the international competitive advantage of industries and reinforce domestic industries' foothold on the global supply chain, a company that engages in technological innovation in Taiwan, occupies a key position in the international supply chain, and meets the following conditions may enjoy a tax credit of 25% of the **amount that it spends on the forward-looking innovative R&D** against its profit-seeking enterprise income tax payable in the then-current year, up to 30% of the amount of the profit-seeking enterprise income tax payable in the then-current year: 1. The amount of the company's R&D expenses and the percentage of such expenses to its net operating revenues for the same taxable year reach certain thresholds. 2. The effective tax rate applicable to the company in the then-current year is not lower than a certain percentage. 3. The company has not committed any severe violation of any environmental protection, labor, or food safety and sanitation laws in the past three years.

Where a company meets the requirements specified in the preceding Paragraph and the amount that it spends on the purchase of **new machinery or equipment** for its own use **in advanced manufacturing processes** reaches a certain threshold, the company may enjoy a tax credit of 5% of such amount against its profit-seeking enterprise income tax payable in the then-current year, up to 30% of the amount of the profit-seeking enterprise income tax payable in the then-current year.
Where a company has applied and been approved for the investment credit under Paragraph 1, none of its R&D expenditures in the then-current year can enjoy the income tax credits or reductions provided for the purpose of encouraging the R&D under Article 10 or Paragraph 1, Article 12-1 of this Statute and other laws; where a company has applied and been approved for the investment credit under the preceding Paragraph, none of its expenditures for the purchase of machinery and equipment in the then-current year can enjoy the income tax credits or reductions for investment in machinery or equipment under the preceding Article and other laws.
Where a company has applied and been approved for both the investment credits under Paragraphs 1 and 2 or is concurrently applicable for such investment credits and any other investment credits under this Statute or other laws in the same year, the total amount creditable in the then-current year shall not exceed 50% of its profit-seeking enterprise income tax payable in the then-current year, unless, under other laws, the then-current year is the final creditable year and there is no limitation on the creditable amount.
The effective tax rate referred to in Subparagraph 2, Paragraph 2 shall mean the percentage of the amount of the tax payable by a company in the then-current year as calculated pursuant to Paragraph 1, Article 71 of the Income Tax Act, after deducting the tax reductions for the income tax paid on overseas income in the country of origin under the tax laws of that country, the tax reductions for the income tax already paid in the People's Republic of China (PRC) or any third area on PRC-sourced income, and the investment credits under this Statute and other laws, to its annual income; such percentage shall be 12% for 2023 and 15% from 2024 onwards; however, the percentage for 2024 may be adjusted to 12% based on the review by the central competent authority in conjunction with the Ministry of Finance of how the international community enforces the Organization for Economic Cooperation and Development's Global Minimum Corporate Tax; such adjustment shall be subject to the

approval of the Executive Yuan before being promulgated by the central competent authority in conjunction with the Ministry of Finance.
The scope of applicability, eligibility requirements, thresholds, application deadline, application procedure, authority granting approval, calculation of the total creditable amount in the then-current year, and other related matters for the investment credits under the preceding five Paragraphs shall be determined by the central competent authority in conjunction with the Ministry of Finance.

2. Article 72 Paragraph 6

The Articles amended on January 7, 2023 shall be implemented from January 1, 2023 to December 31, 2029.

II. Types of Tax Incentives:

1. The investment credit is 25% for **"forward-looking innovative research and development expenditures"** in the then-current year. (Taiwan, Ministry of Economic Affairs, Article 10-2 Paragraph 1 of the Statute)
2. The investment credit is 5% for the "**acquisition of machinery and equipment used in advanced manufacturing processes"** with no limit to the creditable amount if the expenses reach a certain threshold in the then-current year. (Taiwan, Ministry of Economic Affairs, Article 10-2 Paragraph 2 of the Statute)

III. Applicable Statutory Requirements:

1. Active Requirements

(1) Within Taiwan

Q: Should all companies established within Taiwan be eligible under this Amendment? Is this Amendment applicable if the innovation is conducted overseas? Essentially, this law encourages firms to engage in R&D activities independently through tax incentives to increase the firm's competitiveness, help reinforce the corporation's key position in the international supply chain, and also potentially stimulate the development of related industries as well as middle and lower stream industries; additionally, should the spillover effect occur in Taiwan, it would then align with the purpose of awarding such benefits. Therefore, according to Article 7 of the Sub-law Draft, the "forward-looking innovative research and development expenditures" part, unless there are special considerations that can allow for foreign companies, institutes for higher education, executive research organizations to be eligible, **only practitioners within Taiwan may be recognized** (Taiwan, Ministry of Economic Affairs). As for the "purchase of new machinery or equipment for its own use in advanced manufacturing processes," such new machinery or equipment should be for the firm's own use and the installation location is **restricted to** within the company itself or a leased **production site in Taiwan** (Taiwan, Ministry of Economic Affairs). However, due to certain characteristics of industries whereby machinery or equipment must be installed in designated domestic locations, the restriction does not apply.

(2) Key Position in the International Supply Chain

According to Article 2 of the Sub-law Draft, the so-called key position in the international supply chain refers to **"companies producing products or services that have an impact on the international market"** (Taiwan, Ministry of Economic Affairs)**.** When applying, the company must provide an explanation and supporting documentation (such as company products, share of services within the international market, ranking, imports and exports, and other figures that establish the company's impact, etc.) which will be reviewed after the central competent conducts a comprehensive assessment on the then-current situation of the industry's development.

(3) Company

Unlike Article 10 and Article 10-1 which applies to "companies or limited partnerships", Article 10-2 only regulates companies under the Company Act and does not apply to limited partnerships (Taiwan, Ministry of Economic Affairs).

(4) Subject of Investment Are "Forward-looking Innovative Research and Development Expenditures" or "Acquisition of Machinery and Equipment Used in Advanced Manufacturing Processes Expenditures"

(i) "Forward-looking Innovative Research and Development Expenditures"

According to the regulations specified in Paragraph 2 of Article 2, the so-called forward-looking innovative research and development refers to "companies that engage in innovative applied R&D activities for leading international technology or mature manufacturing process technology" (Taiwan, Ministry of Economic Affairs). According to the Draft definition, "leading international technology" refers to aforementioned technologies that lack an overall practical maturity within the country or abroad, but have a strategic competitive advantage in future industry development (Taiwan, Ministry of Economic Affairs). Moreover, considering the competitive advantage domestic companies have in the development and innovation of mature technologies, companies that have relatively mature technologies in the global market, engage in innovative applied R&D, promote the aforementioned technologies as to produce a leading technology or develop a new form of technological application, are eligible as well. Additionally, according to the regulations in Article 7 of the Sub-law Draft, products or technologies of forward-looking innovative research and development are only for the company's own use and if the product is produced or used by other parties, reasonable royalties or remuneration shall be acquired (Taiwan, Ministry of Economic Affairs).

(ii) "Acquisition of Machinery and Equipment Used in Advanced Manufacturing Processes" (Taiwan, Ministry of Economic Affairs)

According to regulations in Paragraph 3 of Article 2, the so-called machinery and equipment used in advanced manufacturing processes refers to a company that engages in developing leading international technology that can be mass produced commercially, or the purchase of new machines or equipment for developing the innovative application of mature manufacturing technologies that have already reached commercial mass production.

(5) "Research and Development Expenses" and "Research and Development Expenses as a Percentage of Net Operating Income" Must Reach a Certain Threshold in the Same Tax Year

According to Article 3 of the Sub-law Draft, "the research and development expenses reaching a certain threshold in the same tax year" requires R&D expenses to reach **six**

billion NTD for the same tax year, whereas "research and development expenses as a percentage of net operating income reaching a certain threshold in the same tax year" requires R&D expenses **as a percentage of net operating income** for the same taxable year to **reach six percent** (Taiwan, Ministry of Economic Affairs).

(6) Effective Tax Rate Reaching a Certain Percentage

The effective tax rate, also known as the real tax rate is, conceptually, the ratio of actual taxes paid to the total annual income amount. The effective tax rate formula from the Article is as follows:

$$\text{Effective Tax Rate} = \frac{(\text{tax payable}) - (\text{tax deductible paid on overseas income}) - (\text{tax deductible paid on PRC income}) - (\text{total applicable investment tax credit})}{\text{total annual income}}$$

And in terms of the "certain percentage", the effective tax rate in 2023 is to reach 12%, and 15% after 2024 (Taiwan, Ministry of Economic Affairs). (As the international community has yet to reach a consensus on the implementation period of the OECD global minimum corporate tax system, a 12% tax rate, and not the prescribed 15%, shall be implemented, which give domestic industries a buffer period; And by the same token, related authorities may change the rate to 12% in 2024 depending on the situation)

(7) Amount Spent on the Purchase of New Machinery or Equipment in Advanced Manufacturing Processes Reaches a Certain Threshold (Credit Only Applies to Those Who Meet Requirement in Paragraph 2 of Article 10-2)

According to article 10 of the Sub-law Draft, the "amount spent on the purchase of new machinery or equipment in advanced manufacturing processes reaches a certain threshold" refers to a company's total amount of expenditure on the acquisition of new machinery or equipment for their own use in advanced manufacturing processes reaching **ten billion NTD** in the same tax year (Taiwan, Ministry of Economic Affairs).

2. Passive Requirements

(1) Concurrent Applications for the **Same Types of Investment Credits Are Not Allowed**

a. Applications for investment tax credit for "forward-looking innovative research and development expenditures": **total** research and development expenditures for the current year shall not earn tax credit by reapplying Article 10 and Article 12-1 or other laws that serve to encourage research and development (Taiwan, Ministry of Economic Affairs).

b. Applications for investment tax credit for "total expenditure of new machinery or equipment in advanced manufacturing processes": If the total amount of expenditure on the acquisition of new machinery or equipment for use in advanced manufacturing processes during the year complies with both Article 10-1 of the Statute and other laws that encourage investment in machinery and equipment, only one application may be selected for use (Taiwan, Ministry of Economic Affairs). If a portion of the total expenditure of new machinery or equipment meets the requirements of Paragraph 2 of Article 10-2, while the remaining portion does not meet such requirements but complies with Article 10-1 or other machinery and equipment investment tax credit regulations, the remaining portion shall not apply Article 10-1 and other tax credit regulations.

✧ Other investment tax credit regulations that cannot be reapplied are, for example, Articles Five and Six of the *Development of Biotech and Pharmaceutical Industry Act*, Articles Thirty Seven of the *Promotion of Private Participation in Infrastructure Projects Act,* Articles Twenty Nine of the *Statute for Encouragement of Private Participation in Transportation Infrastructure Projects*, Articles Twenty Three of the *Resource Recycling Act* and Articles Fourteen and Twenty Four of the *New Town Development Act*, etc (Taiwan, Ministry of Economic Affairs; Ministry of Finance; Ministry of Transportation and Communications; Environmental Protection Administration; Ministry of the Interior).

(2) The Total Amount of Credit Received Shall Not Exceed the Statutory Limit.

a. Investment credit for "forward-looking innovative research and development expenditures must not exceed 30% of the company's income tax payable for the same tax year (Taiwan, Ministry of Economic Affairs).

b. Investment credit for total expenditure of new machinery or equipment in advanced manufacturing processes" must not exceed 30% of the company's income tax payable for the same tax year (Taiwan, Ministry of Economic Affairs).

c. The amount of investment credit approved for a company under this Article or a combination of this Article and other investment credit laws, shall not exceed 50% of the amount of income tax payable by the corporation for the same tax year. (However, under other laws, if the then-current year is the final creditable year and there is no limitation on the creditable amount, the restriction does not apply)

✧ According to Article 11 of the Sub-law Draft, the "company's income tax payable for the same tax year" refers to the credit, approved by tax collection authorities, against the amount of tax payable for profit-seeking enterprises in the then-current year calculated according to the tax rate of the *Income Tax Act* as well as the taxable amount, approved by tax collection authorities, on undistributed earnings of the previous year calculated according to the tax rate of the *Income Tax Act* (Taiwan, Ministry of Economic Affairs).

(3) No Material Violation of Environmental Protection, Labor or Food Safety and Health Related Laws Within Past Three Years:

In terms of "material violation of environmental protection, labor or food safety and health related laws," refer to the "Ministry of Economic Affair's Significant Points for Identifying Material Violations of Environmental Protection or Food Safety and Other Related Laws in Investment Credit and Incentives Cases" (Taiwan, Ministry of Economic Affairs). (Official English title of this law is not yet available)

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