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Adding another wrinkle to Taiwan CFC: Taiwan just implements new legislation which may impact offshore trust or insurance structure if it holds Taiwan real estate

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Summary

In addition to our previous sharing on Taiwan controlled foreign company ("CFC") issues, our team has also been focusing on how best to structure assets with *situs* in Taiwan, which may include Taiwan real estate.

The amended Income Tax Act (**Amendment**), which stipulates new "see-through" rules on the taxation of Taiwan real estate, has come into effect on **1 July 2021 and retrospectively applied on real estate acquired after January 1, 2016**. Under this Amendment, holding company structure would be disregarded and the sale of the holding company, which directly or indirectly holds Taiwan real estate constituting half of the company's value, could be deemed as a sale of the underlying real estate subject to capital gain tax up to 45%. Without this rule, the sale of shares of the holding company may only give rise to a tax up to 20%. Though not exactly the same, the advice and planning techniques on U.S. Foreign Investment in Real Property Tax Act (**FIRPTA**) could be good reference to future planning.

The new see-through rule applies to income tax only. Although this rule reinforces the preference to hold Taiwan real estate through individual title from income tax perspective, wealth planners should review existing structures and consider various angles for planning in the future, in particular on criminal risk assessment of trustees and insurance companies.

When a structure is used to hold Taiwan real estate, we also see growing interest recently in putting the holding company in an offshore trust or an offshore insurance policy. Given the imminent application of the CFC rules and the above Amendment, additional analysis (and future regulatory scrutiny) may highlight some additional questions, which we summarize below:

1. Can an offshore trustee/insurance policy still hold Taiwan real estate?

<u>**Yes, subject to prudent assessment on criminal risk.**</u>

Double-layer holding structure (i.e. holding through both offshore holding company and onshore holding company) requires additional Taiwan regulatory approval regardless of whether it is under a trust or an insurance policy. In such approval the regulator will require information of the ultimate beneficial owner (UBO). If a Taiwan individual retains control but on the document it only shows the insurance company or a secretariat company being the only UBO, after CFC and the Amendment we believe this might cause misstatement, tax avoidance and even document forgery risk. We have seen a handful cases in the past in this area. However, to deal with CFC issues we see a trend to promote more of these UBO structure. This may invite scrutiny from the regulator not only to current but also to previous cases.

2. **What are the tax implications for an offshore trustee/insurance policy holding Taiwan real estate?**

   Calculation of holding period and basis step-up are important.

   The applicable tax rates on real estate trading (from 20% to 45%) are determined by the holding period and holding structure. In order to calculate the holding period, we need to determine whether settling such real estate into a trust or insurance policy will re-calculate the holding period. For planning purpose we should avoid the re-calculation. Trustees or insurance companies should also obtain a legal opinion as to whether the real estate has basis step-up at various timings (e.g. death of policy holder/settlor, distribution to beneficiaries) to avoid unfavorable tax implications on heirs as opposed to not settling the real estate into trusts/insurance policies.

3. **How the Amendment and CFC together would affect estate planning for Taiwan residents?**

   An important takeaway is that wealth planners should not only focus on tax advice but also legal advice if the planning includes Taiwan regulatory approvals.

   Taiwan promulgates new rules on real estate and CFC, but it did not reinvent the wheel. It basically follows U.S. taxation on real estate holding company (e.g. FIRPTA) and CFC, and just like one needs to deal with IRS and DOJ in the U.S., in Taiwan the most risky area is never the tax authority but the Taiwan Ministry of Justice Investigation Bureau and the judicial system.

If more detailed explanation or further assistance is required, please feel free to contact us.

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