EXPLANATORY MEMORANDUM TO

THE DOUBLE TAXATION RELIEF AND INTERNATIONAL TAX ENFORCEMENT (TAIWAN) ORDER 2021

2021 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The instrument brings into effect arrangements set out in a Protocol (the 2021 Protocol) made by the British Office Taipei and the Taipei Representative Office in the United Kingdom. The 2021 Protocol amends the existing arrangements between the two territories for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains, signed in 2002 (the 2002 Arrangements).

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 The Rt Hon Lucy Frazer QC MP, Financial Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Double Taxation Relief and International Tax Enforcement (Taiwan) Order 2021 are compatible with the Convention rights."

6. Legislative Context

6.1 The instrument is being made to give effect in United Kingdom legislation to the 2021 Protocol, which has been signed by the two territories. The arrangements in the 2021 Protocol are specified in the Schedule to the instrument.

7. Policy background

What is being done and why?

7.1 The purpose of Double Taxation Agreements (DTAs) is to prevent income or gains being taxed both in the territory in which they arise and the territory in which the recipient is resident. They do this either by allocating an exclusive right to tax the income or gain to one of the territories, or by providing that one territory must give relief for the tax charged in the other territory in respect of the same income or gain.

DTAs also provide additional protection for taxpayers through specific measures combating discrimination in tax treatment. More generally, they benefit the taxpayer by ensuring certainty of treatment and, as far as possible, by reducing compliance burdens.

7.2 DTAs also protect the Exchequer by including provisions to combat tax avoidance and evasion. For example, they provide for the exchange of information between revenue authorities making it more difficult for residents of both territories to evade taxation by concealing assets offshore.

7.3 Like all of the United Kingdom's more recent DTAs and protocols amending them, the 2021 Protocol largely follows the approach adopted in the Organisation for Economic Cooperation and Development's (OECD) latest Model Tax Convention on Income and on Capital (OECD Model). In doing so, it encourages and maintains international consensus on the appropriate tax treatment of cross-border economic activity, promoting international trade and investment.

7.4 The government keeps all of the United Kingdom's DTAs under review to ensure that they are in line with current policy. Updating the DTA now to follow many of the latest provisions in the OECD Model will make it easier for business to understand, remove obstacles to cross-border trade and investment and reflect changes in policy and domestic tax legislation since the earlier DTA was signed.

7.5 The 2021 Protocol includes the minimum standards recommended by the OECD/G20's Base Erosion and Profit Shifting (BEPS) project, which are designed to prevent DTAs from being abused by people trying to reduce their tax liability where the DTA is not intended to apply. The BEPS project created a single set of consensus-based international tax rules to protect against tax avoidance while offering increased certainty and predictability to taxpayers. These provisions are now included in the 2017 version of the OECD Model.

The following paragraphs explain the main changes introduced by the 2021 Protocol including the main differences from the 2002 Arrangements and rationale for material departures from the OECD Model

7.6 Article I replaces the title of the 2002 Arrangements to include the new OECD Model wording explicitly mentioning tax avoidance as well as evasion. The change to the OECD Model arose from the BEPS Action 6 Report on preventing the granting of treaty benefits in inappropriate circumstances.

7.7 Article II modifies the preamble of the 2002 Arrangements to include a statement that the United Kingdom and Taiwan intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. This statement is one of the elements of the minimum standard on preventing treaty abuse agreed under the BEPS project.

7.8 Articles III and IV update the names of the British Office in Taipei and the United Kingdom Competent Authority which have changed since the 2002 Arrangements.

7.9 Article V amends Article 1 (Persons covered) of the 2002 Arrangements which sets out the general scope of the arrangements. The 2021 Protocol includes two provisions from the OECD Model that are absent from the 2002 Arrangements. The first concerns the treatment of income or gains derived through fiscally transparent entities such as partnerships. This provision was one of the recommendations of the BEPS project and confirms that the benefits of the 2002 Arrangements are only due where

such income is effectively taxed in the hands of a resident of one of the territories. The second provision clarifies that the 2002 Arrangements do not prevent a territory taxing its own residents except where they explicitly provide as such. This provision was also recommended by the BEPS project and puts beyond doubt that the provisions of a DTA cannot be used to circumvent anti-avoidance rules in a territory's domestic tax law.

7.10 Article VI amends Article 2 (Taxes covered) of the 2002 Arrangements which lists the taxes to which the arrangements apply. The existing United Kingdom taxes to which the 2002 Arrangements will apply are income tax, corporation tax and capital gains tax. For Taiwan, the income basic tax has been added to the existing taxes covered which are the profit seeking enterprise income tax and the individual consolidated income tax.

7.11 Article VII changes the definition at paragraph 1(f)(ii) of Article 3 (General definitions) from the Director-General of the Department of Taxation of Taipei to the Minister of Finance for Taipei.

7.12 Article VIII updates Article 4 (Residence) of the 2002 Arrangements which establishes the meaning of "resident of a Contracting State" and lays down detailed rules for resolving cases where individuals or other persons may be considered residents of both territories for tax purposes under their domestic laws. Under paragraph 4 of the 2021 Protocol the competent authorities will endeavour to determine the residence status of persons, other than individuals, by mutual agreement, whereas under the 2002 Arrangements such matters were determined based on the place of effective management of the person. This change was introduced to the OECD Model following the BEPS project and prevents companies manipulating their tax residence for avoidance purposes.

7.13 Article IX modifies Article 10 (Dividends) of the 2002 Arrangements. Article 10 contains the rules for the taxation of dividends paid by a company that is a resident of one territory to a resident of the other territory. It provides that dividends paid by a company resident in one territory to a beneficial owner resident in the other territory be subject to a withholding tax of a maximum of 10% in the paying territory. However, dividends paid by Real Estate Investment Trusts will be subject to a withholding tax of a maximum of 15%. In other respects, the provisions of the Article follow the OECD Model. Additionally, the 2021 Protocol removes the anti-abuse provision which is no longer necessary following the introduction of a principal purpose test (PPT) by Article XVII.

7.14 Article X modifies Article 11 (Interest) of the 2002 Arrangements. Article 11 contains the rules for the taxation of interest arising in one territory and paid to a resident of the other territory. The 2021 Protocol removes paragraph 7, the anti-abuse provision, which is no longer necessary following the introduction of a PPT by Article XVII and makes consequent adjustments to the internal numbering of the paragraphs.

7.15 Article XI modifies Article 12 (Royalties) of the 2002 Arrangements. Article 12 contains the rules for the taxation of royalties paid by a resident of one territory to a resident of the other territory. The 2021 Protocol removes paragraph 7, the anti-abuse provision, which is no longer necessary following the introduction of a PPT by Article XVII.

7.16 Article XII modifies Article 13 (Capital gains) of the 2002 Arrangements. Article 13 contains the rules for the taxation of gains deriving from the alienation of property

situated in one territory by a resident of the other. The Article amends the "securitised land provision" which allows a territory to tax a disposal of shares or comparable interests where those shares or interests derive more than 50% of their value from immovable property in that territory. Unlike the "securitised land provision" in the OECD Model, the provision in the Article does not include a 365-day holding test. The government believes that the holding test could lead to double taxation and is unnecessary due to the introduction of the PPT at Article XVII of the 2021 Protocol. In other respects, the Article follows the OECD Model.

7.17 Article XIII modifies Article 23 (Limitation of relief) of the 2002 Arrangements. Article 23 limits the relief available under the 2002 Arrangements to ensure that it is consistent with the amounts actually taxable in the relevant territory. The 2021 Protocol removes paragraph 2, the anti-abuse provision, which is no longer necessary following the introduction of a PPT by Article XVII and renumbers the paragraphs.

7.18 Article XIV modifies Article 24 (Non-discrimination) of the 2002 Arrangements. Article 24 provides that subject to certain conditions neither territory shall impose discriminatory taxes or connected requirements on the nationals, permanent establishments and enterprises of the other. The 2021 Protocol updates the cross references to other provisions of the 2002 Arrangements which have been modified by the Protocol.

7.19 Article XV modifies Article 25 (Mutual agreement procedure) of the 2002 Arrangements. This updates the procedure for resolving difficulties arising from the application of the 2021 Protocol and meets the minimum standard on improving dispute resolution agreed under Action 14 of the BEPS project. The Article ensures that mutual agreements can be implemented notwithstanding time limits in domestic law and includes a provision confirming that the competent authorities may consult to eliminate double taxation in cases not covered by the 2002 Arrangements. This amendment ensures that the DTA meets the BEPS minimum standard on effective dispute resolution.

7.20 Article XVI replaces the text of Article 26 (Exchange of information) of the 2002 Arrangements to follow the latest OECD Model and provides for the exchange of certain information between the competent authorities of the two territories in compliance with international standards.

7.21 Article XVII inserts a new Article 27 (Entitlement to benefits) into the 2002 Arrangements. It contains the PPT which denies treaty benefits to those seeking to take advantage of the provisions of the 2002 Arrangements to secure a result which is contrary to their object and purpose. The PPT is one of the elements of the minimum standard on preventing treaty abuse agreed under the BEPS project. It also renumbers the other provisions of the 2002 Arrangements as a consequence of the insertion of this new provision.

7.22 Article XVIII sets out how the 2021 Protocol will enter into force and when the provisions of the Protocol will take effect.

7.23 Article XIX explains that the 2021 Protocol forms an integral part of the 2002 Arrangements and provides for signature by the officials of the territories.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 An informal consolidated version of the 2002 Arrangements will be published on the HMRC pages of the www.gov.uk website on entry into force of the 2021 Protocol.

10. Consultation outcome

10.1 HMRC regularly consults with external interested parties, including business representatives, about the United Kingdom's network of DTAs.

11. Guidance

11.1 General guidance on the operation of the United Kingdom's (UK) double taxation agreements can be found on the HMRC pages of the gov.uk website at:

https://www.gov.uk/hmrc-internal-manuals/international-manual/intm150000

or in the Double Taxation Relief Manual at:

https://www.gov.uk/hmrc-internal-manuals/double-taxation-relief

This Manual will be updated once the 2021 Protocol enters into force.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies. The provisions of the 2021 Protocol do not introduce new tax burdens; rather, they ensure that relief from UK tax under the 2002 Arrangements is only granted in circumstances where it was intended.

12.2 There is no, or no significant, impact on the public sector.

12.3 A Tax Information and Impact Note has not been prepared for this instrument as it is gives effect to a protocol amending a double taxation agreement. Double taxation agreements impose no obligations on taxpayers, rather they seek to eliminate double taxation and fiscal evasion.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific steps are proposed to minimise the impact of the requirements on small businesses (employing up to 50 people).

13.3 The basis for the final decision on what action to take to assist small businesses is that the DTA only applies if they have taxed income arising in Taiwan. As with other businesses, the impact is negligible. No special approach for small businesses is therefore necessary.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is that both territories will keep the 2021 Protocol scheduled to the instrument under consideration to ensure that it continues to meet the policy objectives set out above in Section 7.

14.2 The instrument does not include a statutory review clause. None is required under section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015 because the power by which this instrument is made is being exercised so as to make or amend

provisions imposing, abolishing, or varying any tax duty, levy, or other charge or provisions in connection with such provisions.

15. Contact

15.1 Helen Baird-Parker at HMRC Telephone: 03000 586141 or email: helen.baird-parker@hmrc.gov.uk can be contacted with any queries regarding the instrument.

15.2 Fiona Hay, Deputy Director for Business, Assets and International, at HMRC can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Lucy Frazer QC MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.