

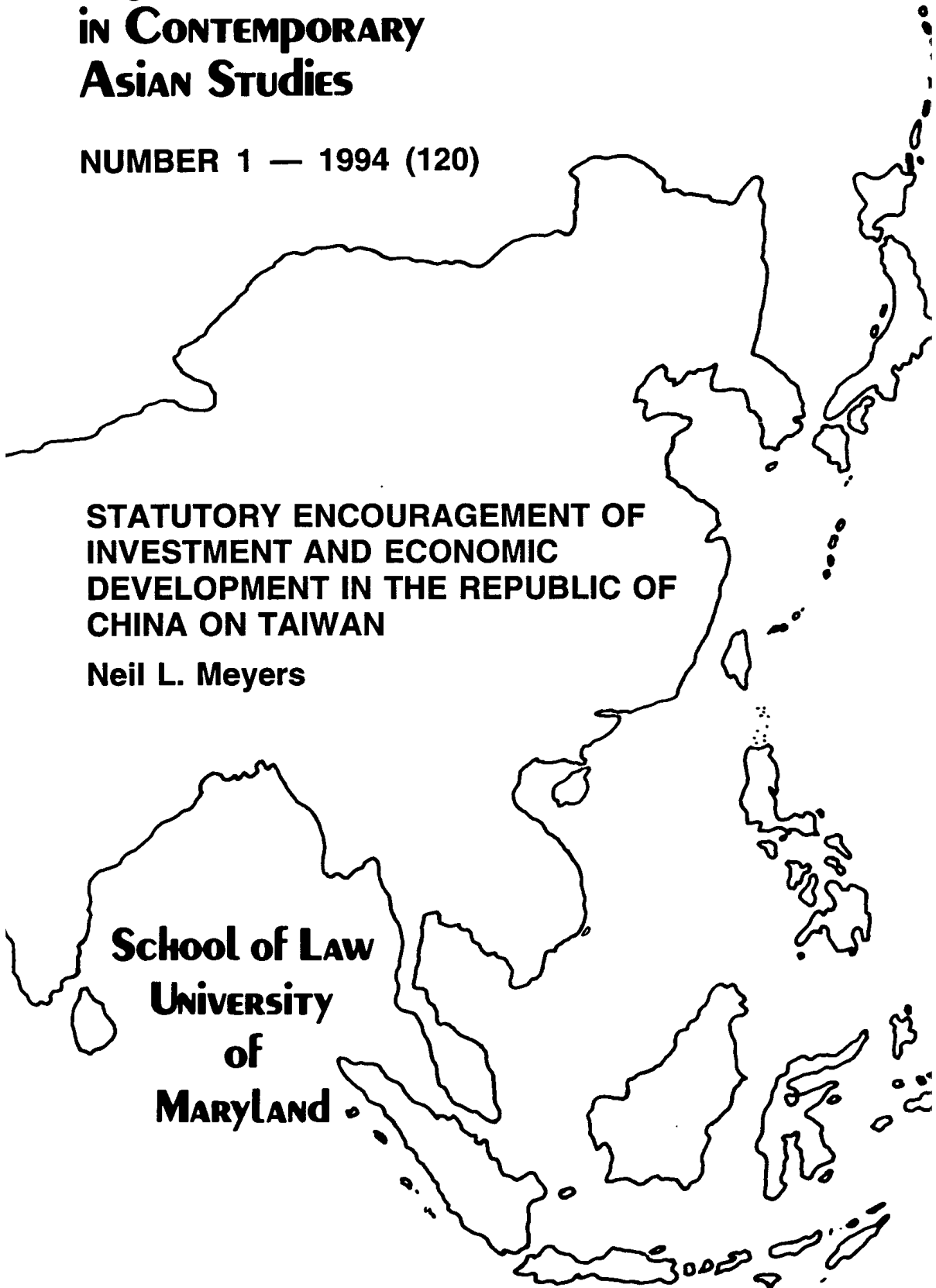
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**STATUTORY ENCOURAGEMENT OF
INVESTMENT AND ECONOMIC
DEVELOPMENT IN THE REPUBLIC OF
CHINA ON TAIWAN**

Neil L. Meyers

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University
of
Maryland**



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PREFACE

The purpose of this paper is to introduce an element of Taiwan's legal system that has played an important role in Taiwan's economic development: specifically, the statutory encouragement of investment.

The field of economic development is driven by business and investment decisions based on economics, for which there really is no body of case law. The relevant laws are statutes and various administrative regulations, guidelines and procedures.

Although there are administrative decisions, rulings and opinion letters which, in practice, would be relevant to application of these statutes and regulations, such materials are not always readily available, even in Taiwan. This paper is based on research materials collected by the author here in the United States, where no such administrative materials were available. Therefore, the style of this paper differs somewhat from an ordinary American-style law review article and is somewhat closer to the style of articles found in Asian legal and business journals. There is no analysis of case law or administrative precedents. Instead, this paper discusses some of the most important statutes and regulations directly, and considers their role in encouraging Taiwan's economic development. This paper also gives some consideration to how this role is now changing as the legal system adapts to fit Taiwan's evolving economic conditions.

Taiwan's economy is governed and regulated by a system of interrelated statutes and administrative regulations whose corresponding and interlocking provisions provide the legal foundation for Taiwan's economy. Obviously, there are many more statutes and regulations that are relevant to Taiwan's business and commercial practice than can be addressed in a single paper. This paper focuses on a few of the most fundamentally important and universally applicable ones.

INTRODUCTION

The so-called "economic miracle" achieved by the Republic of China on Taiwan¹ is by now well known. What is not so well known perhaps is how this small, politically isolated, resource poor, island

1. The author assumes that the reader is familiar with the somewhat unusual political position of the R.O.C. government and therefore this paper will not discuss the technicalities relating to the difference between the names "The Republic of China", "Taiwan" and "The Republic of China on Taiwan." In this paper, these names will be

"nation" has emerged as an economic power. Taiwan's economic success was built primarily by the work ethic and entrepreneurial talents of the Chinese people. In also was built by government policies which has encouraged those energies and skills and channeled them into economically strategic areas.

Chinese business people are by nature entrepreneurial and individualistic. Business practices in Taiwan often bear more resemblance to the individualistic, entrepreneurial American model rather than the more group-oriented Japanese model.² Accordingly, Taiwan's "economic miracle" has been built upon the success of many small and medium-size companies rather than by huge industrial/financial groups such as Japan's *keiretsu* or South Korea's huge conglomerates. And there is really no "Taiwan, Inc." equivalent to the so-called "Japan, Inc." we hear so much about these days.

Government policy also has played an important role in Taiwan's rapid economic growth: over the past forty years, R.O.C. policies have actively encouraged economic development.

From the early use of government-owned industrial companies to develop the basic industrial infrastructure, to the provision of capital to various sectors of the economy through government owned banks, the R.O.C. government has used various measures to implement economic policy and to encourage economic growth throughout the different stages of Taiwan's economic development.

Notwithstanding the importance of such measures, clearly the R.O.C. government's most important role in fostering economic growth was to create a stable investment climate in which business people will have confidence. Only then will the people's entrepreneurial energies, business talents, and willingness to work be brought into the marketplace. This is achieved through political and social stability³ and a legal system which gives investors some measure of confidence and certainty.

Once this fundamental requirement has been achieved, the government may then institute policies to help direct and channel those energies and talents into the sectors of the economy which

used interchangeably to refer to the area administered by the R.O.C. government, i.e., Taiwan.

2. It is commonly stated that one in every four Taiwanese owns a company.

3. This paper will not address the numerous political issues that could easily be raised at the point in the discussion. How the necessary political stability was achieved on Taiwan, and the pros and cons of the authoritarian system used to achieve it is a separate topic. This paper will concentrate on the economic areas of the legal system.

are targeted as the most productive and the most strategically important for economic development. This is the area in which Taiwan's legal system has played an important and effective role through a system of statutes and regulations that encourage savings and investment, and which direct this investment into productive sectors of the economy.⁴

This paper will examine certain important aspects of the R.O.C. legal system and their roles in Taiwan's remarkable economic growth. It also will consider some of the challenges the system now faces as Taiwan's economy enters a new era.

CHAPTER I—TAIWAN'S ECONOMIC PERFORMANCE

Over the past forty years, Taiwan's average annual rate of real GNP growth was 8.9%, while the inflation rate was held to around 3%, and during the past twenty years unemployment has averaged about 2%.⁵ In 1951, per capita income was US\$ 145, but by 1990, per capita income had reached US\$ 8,000.⁶ This performance has moved the R.O.C. from a traditional, agriculturally based, less developed country (LDC) into the ranks of the newly industrialized countries (NIC). According to the most recent statistics released by the Executive Yuan (the Cabinet), Taiwan's GNP grew by 7.2% in 1991 and is predicted to continue to grow at approximately 7% during 1992. The same report also projected that Taiwan's per capita income will break US\$10,000 in 1992.⁷ In addition, the R.O.C. government projects that by the turn of the century, per capita income

4. Considering the current state of the U.S. economy and our dwindling international competitiveness, perhaps we could learn from the economic policies of the R.O.C. and from how these policies have been implemented through the legal system. To take one example, consider the tax incentives discussed later in this paper and compare them to our tax code, which offers few if any incentives for capital investment or research and development. Consider also which is more beneficial to the national economy as a whole: providing some certainty and incentives for productive economic activities or temporary tinkering with the tax code to pander to perceived political interest groups.

5. Kuo, Shirley W.Y., Chairman, Council for Economic Planning and Development, Speech Delivered at the 14th Joint Economic Conference of ROC-USA & USA-ROC Economic Councils, November 15, 1990, Taipei. Reprinted in *Reference Papers on Economic Development and Prospect of the Republic of China*, Compiled by Board of Foreign Trade, Ministry of Economic Affairs, Republic of China, April 1991 (hereinafter cited as *Reference Papers*).

6. Sheu, K.S., Director General, Board of Foreign Trade, Ministry of Economic Affairs, in *Reference Papers*, *supra* note 5.

7. *Shih Chie Jih Pao* (World Journal) (A Chinese language newspaper serving North America), February 21, 1992, p. 5.

will reach US\$ 15,000, bringing Taiwan into the ranks of the fully developed countries.⁸

In 1989, Taiwan was the 13th largest trading nation in the world, with a total external trade volume of US\$ 118.5 billion.⁹ In 1990, Taiwan moved up to become the world's 12th largest trader and 17th richest nation.¹⁰ Taiwan's foreign reserve deposits are the world's largest, totaling US\$ 83.215 billion at the end of February 1992.¹¹

At the end of 1985, the exchange rate of the New Taiwan Dollar (NT\$) to the U.S. dollar was NT\$39/US\$1. By 1989 the rate was NT\$26/US\$1. The NT\$ has appreciated against the US\$ by more than 52% in less than 4 years.¹² During this period labor wage rates also increased significantly. As a result of these increased labor costs and the appreciation of the NT\$, the traditional labor-intensive, low-capital, low-technology industries that built the foundation of Taiwan's economic success were no longer competitive in the international market. This necessitated a structural shift in the economy away from the traditional labor-intensive manufacturing industries, such as textiles and footwear, toward new, high-technology, capital-intensive industries, such as advanced computer industries, bio-technology and aerospace. Traditional labor-intensive manufacturing has been moved off-shore to places such as mainland China, Thailand and Malaysia, and capital-intensive, high-technology areas are targeted for rapid development.

During the past forty years, the R.O.C. government has instituted and practiced policies that encourage investment and stimulate the economy. For the most part these policies have been remarkable successful, as the statistics discussed above demonstrate. However, many of these long-standing policies are now outdated and must be liberalized to adapt to Taiwan's maturing, modernized economy and to secure Taiwan's place as a major player in the global economy.

Taiwan's financial services sectors have been controlled tightly by government regulations for the past forty years. In many important areas of the financial sector, government regulations have not

8. See *supra* note 6.

9. *Ibid.*

10. Soong, Dr. James C.Y., Secretary General, Kuomintang of China, in *Reference Papers, supra* note 5.

11. *Shih Chie Jih Pao* (World Journal), April 16, 1992.

12. Wu, Rong-I, Professor of Economics, National Chung Hsing University, in *Reference Papers, supra* note 5.

kept pace with Taiwan's rapid development and new-found prosperity. Under its current policy of modernization, liberalization and internationalization, the R.O.C. government is adapting the legal system to fit Taiwan's modern economy. In order to adjust the legal system's regulatory framework to accommodate Taiwan's new economic position, many statutes and regulations are being amended and new laws are being promulgated. Changes are taking place in many areas, including capital markets, banking services, insurance services, foreign exchange, and availability and diversity of investment opportunities and services.

In addition to the changes now taking place in the regulatory environment, the R.O.C. government also has announced an ambitious Six Year (1991-1996) National Development Plan. The most important policy goals of the Six Year Plan are "raising national income, providing sufficient resource for continuous industrial growth, promoting a balanced regional development, and upgrading the quality of life."¹³ The Plan includes 779 projects with a total budget of over US\$ 330 billion,¹⁴ including several hundred public investment projects, the total budget for which is about US\$ 190 billion.¹⁵

The current R.O.C. government policies of modernization, liberalization and internationalization of the legal and regulatory system, combined with the Six Year Plan's efforts to improve the quality of life in Taiwan, should put Taiwan on the fast track for a bright and prosperous future.

I. HISTORICAL SURVEY OF TAIWAN'S ECONOMIC DEVELOPMENT¹⁶

1. Period of Economic Restoration and Rebuilding (1945-1952)

During the Japanese occupation of Taiwan (1895-1945), agricultural production and some basic construction and industrial pro-

13. *An Introduction to the Six Year National Development Plan For Taiwan Republic of China (1991-1996)*, (Republic of China: Board of Foreign Trade, Ministry of Economic Affairs) (hereinafter cited as *Introduction to Plan*).

14. *The New York Times*, October 27, 1991.

15. *Introduction to Plan*, *supra*, note 13.

16. This discussion of the period 1945 through 1983 is based primarily on Sun, Chen and Lee, Kao-chau, "Economic Development of the Republic of China on Taiwan" in Herbert H.P. Ma, ed., *Trade and Investment in Taiwan, The Legal and Economic Environment in the Republic of China*, 2d ed., Taipei: Institute of American Culture, Academia Sinica, 1985. See also Amsden, "Taiwan's Economic History", in Bates, ed., *Toward a Political Economy of Development*, University of California, 1988.

duction facilities were developed, but these facilities were damaged heavily by bombing during World War II. When the Kuomintang government and large numbers of refugees from the Chinese mainland moved to Taiwan in 1949, the large increase in population combined with Taiwan's war-ravaged conditions resulted in severe shortages of basic necessities. This, in turn, resulted in high inflation.

The New Taiwan Dollar (NT) was issued in June 1949 in an effort to fight inflation and stabilize prices by restoring the public's confidence in the value of the currency. The government also instituted a contractionary monetary policy and strongly encouraged savings. Government efforts were directed toward restoring the damaged agricultural, industrial, transportation and communications infrastructure.

In order to stimulate agricultural production, a rent reduction of 37.5% was carried out in 1949, and in 1951 public lands were released to farmers. Government efforts were directed at restoring the industries left by the Japanese and basic industries were targeted for development, including electric power generation, fertilizer production and textile manufacturing. In late 1950, the United States began providing aid commodities to Taiwan. By 1952, agricultural and industrial production had recovered to the peak levels reached under the Japanese occupation and inflation was reduced significantly.

2. Period of Development of Import-Substitution Industries (1953-1960)

In 1953, a "Land to the Tillers" program was instituted under which land was expropriated from large landlords and given to the tenant farmers who actually worked it. The landlords were compensated with shares in government-owned companies, most of which were in the basic industrial sectors targeted by the government for fundamental economic development and infrastructure construction.¹⁷ This successful land reform eliminated landlordism, created an entire class of small landholders and became a model for other developing countries to follow.

The government's policy was stated as "cultivating industry through agriculture, and developing agriculture through industry."

17. This was actually the beginning of Taiwan's securities market, although the Taiwan Stock Exchange (TSE) was not founded until 1962 and was more or less dormant thereafter until 1985.

Assistance was provided to farmers to increase agricultural production in order to increase the basic supply of food, and also to provide the raw materials for agricultural export products. These exports were used to earn foreign exchange, which in turn was used to finance imports of needed industrial equipment and materials. Since foreign exchange resources were limited and Taiwan's level of technological development was low, the government targeted labor intensive industries with low levels of technology and modest capital requirements for development. To help provide materials for local building and construction, industries such as glass, cement, plastics and lumber products were targeted for development. To conserve foreign exchange, local products were substituted for imported necessities such as textiles, paper, flour, edible oils, sewing machines and bicycles.

Protectionist policies such as high import tariffs, foreign exchange controls and import restrictions were implemented to foster the growth of domestic industries by protecting the domestic market.

During this seven year period, these policies produced annual agricultural growth rates as high as 4.5% and annual industrial growth rates of as much as 11.7%. The annual growth rate of GNP reached 7.6% and inflation was brought below 10%. These policies laid the foundation for Taiwan's economic development.

3. Period of Export Expansion (1961-1972)

By the late 1950s, Taiwan's domestic market for the products mentioned above had reached the saturation point. R.O.C. companies had not improved their efficiency or productivity much because protectionism shielded them from competition. The government embarked on a new policy to expand the scale of production in the labor-intensive industries and to encourage exports of their products.

Between 1958 and 1962, the government instituted a series of financial and economic reforms, including the devaluation of the NT\$ and relaxation of some import restrictions. Incentives such as tax rebates on exports and export loans were provided to encourage exports.

It was during this period that the most important and significant legislation was passed to encourage investment and economic

development. The Statute for Encouragement of Investment¹⁸ was promulgated in 1960. This statute offered significant tax incentives for investment, exports and savings. It also provided large amounts of land for industrial development and simplified many administrative procedures.

Throughout the early 1960s Taiwan promulgated statutes and regulations to encourage economic development. In 1962 the Statute for Technical Cooperation¹⁹ was promulgated to attract more advanced levels of technology from overseas. To encourage exports, bonded warehouse and bonded factory systems were established and an Export Processing Zone was established at Kaohsiung (a major port city in southern Taiwan). Taiwan soon became a major exporter of products, such as, textiles, plastics, electrical and electronic appliances, plywood and footwear.

4. Period of Industrial Upgrading and Improving Infrastructure (1973-1983)

As export markets grew rapidly, Taiwan's demand for raw materials and intermediate products used in manufacture of these export products, such as steel and petrochemicals, also grew rapidly. By the late 1960s, this demand was significant enough to support the expansion of the scale of these industries in Taiwan. The benefits offered under the SEI provided incentives to stimulate the investment necessary to develop these sectors. Also, as labor intensive industries grew rapidly, so did the demand for labor. This resulted in some labor shortages and an increase in labor wage rates. As workers' incomes grew, the savings rate increased dramatically, from 12.8% in 1961 to 28.8% in 1971.²⁰ This high rate of savings created the supply of capital which could be channeled into these productive investment. Thus, a domestic supply of investment capital became available.

18. *Chiang Li T'ou Tse T'iao Li* (Statute for Encouragement of Investment), promulgated September 10, 1960, last amended 1987, expired 1990 (hereinafter cited as *SEI*). The SEI was in effect for thirty years and was amended several times during its life. It provided the framework and incentives for the investment that built Taiwan's economy. As of January 1990, the SEI was replaced by the Statute for Upgrading Industries (SUI), which offers a new regime of investment incentives geared to Taiwan's modern economic situation and current development need. Both of these statutes will be discussed further elsewhere in this paper.

19. *Chi Shu Ho Tsuo T'iao Li* (Statute for Technical Cooperation), promulgated August 9, 1962, last amended May 29, 1962.

20. By 1989, the savings rate had exceeded 30%.

These expansions further stressed Taiwan's supporting infrastructure in areas such as electric power supply and transportation, necessitating expansion of these sectors as well. In 1973, the R.O.C. government began the Ten Major Construction Projects which included development of railroads, highways, harbors, nuclear power plants, an airport, the petrochemical industry, a large shipyard and a steel mill. This was the beginning of Taiwan's petrochemical and heavy industries. The increased role of heavy industries and petrochemicals reflected a structural shift in Taiwan's industrial sector. This shift, together with the significant rise in living standards, made Taiwan even more dependent on imported energy supplies. As a result, Taiwan was hit very hard by the oil shocks of the 1970s and economic growth slowed significantly.

In response to these economic setbacks, the government made some policy adjustments. High value-added, less energy-intensive industries were now to be targeted for development, including machinery, information, electronics and transportation equipment. In 1976, interest rate controls were relaxed gradually and a money market was established to help reinvigorate the economy. In 1979, some financial regulations were liberalized and the foreign exchange system was changed from a fixed rate to a floating rate.

The Ten Major Construction Projects were completed between 1977 and 1979. The government followed them with Twelve Construction Projects, which included development of transportation, communications, electrical power, agricultural projects and industrial development projects. Also included were infrastructure development projects, particularly in rural areas, so as to further modernize the country and raise the standard of living.

5. 1983-Present

During the 1980s, Taiwan enjoyed both enormous prosperity and considerable political liberalization and maturation. After having worked diligently for forty years to build their country's economy and their own prosperity, the people of Taiwan began to enjoy the fruits of their labor during this period.

Reacting to trade pressure from the United States, Taiwan began to lower tariffs and other import restrictions significantly. Before long the local market was flooded with imported consumer items. The high savings rate mentioned above provided ready cash for purchases of trendy luxury goods and conspicuous consumption, both quite new to Taiwan.

This excess liquidity also flowed into the Taiwan Stock Exchange (TSE), which took on a casino-like atmosphere as everyone from sophisticated business people to taxi drivers and domestic servants was caught up in the frenzy of an overheated market. This rampant speculation drove the market higher and higher²¹

The TSE was (and still is) undersized and overcapitalized. At the end of September 1989, the market value of TSE listed shares was approximately US\$ 241.3 billion and the registered capital of the listed companies was about US\$ 16 billion, but there were only 167 listed companies.²²

Finally, the bubble burst in early 1990. The TSE hit an all-time high of 12,495.37 on February 10, 1990, and then crashed, declining to as low as 2,560.47 on October 1, 1990. By April 5, 1991, the TSE had recovered to 5,344.84. On January 30, 1992, the TSE stood at 5,391.63 and on May 24, 1993 it closed at 4,258.92.

In addition to speculation on the TSE, an "underground" market developed in the 1980s in an attempt to provide other investment vehicles not legitimately available in Taiwan. This is not really surprising because, as a result of the still highly-regulated environment of the financial sector, the Taiwanese had more money than investment alternatives. Underground investment companies (UICs) offered everything from illegal margin lending to gray-market, mutual fund-type arrangements for investment in overseas markets, to outright pyramid schemes and even an underground futures market. Meanwhile, similar speculation in the real estate sector put tremendous inflationary pressure on commercial and residential rents.

Eventually, the government acted in a two-stage crack-down on UICs. In 1989, the first stage began when the government revised the banking law to prohibit UICs from taking any additional funds from the public.²³ With their supply of capital cut off, the UICs eventually collapsed. Then, in 1990, the second stage began

21. In 1989, in an attempt to cool the market a bit and reduce speculation, Finance Minister Shirley Kuo introduced a tax on stock transactions. However, the public reaction against the tax was so strong that the tax was reduced to nominal levels.

22. "Memorandum of Foreign Trade Regime of the Customs Territory of Taiwan, Penghu, Kinmen, and Matsu", in *Reference Papers*, *supra* note 5.

23. Article 29 of The R.O.C. Banking Law prohibits "deposit taking" activities by "non-bank" institutions "unless otherwise provided for by law". Subsection 1 of Article 29 defines "deposit taking" to prohibit exactly the type of activities the UICs were engaging in.

with criminal proceedings against the leaders of some of the most well-known UICs.

As the bubble of the 1980s burst, Taiwan positioned itself to face the 1990s. A major goal for the nineties is the internationalization of the TSE. In order to accomplish this goal, further liberalization will be required in areas such as foreign exchange restrictions and the opening of the local market to foreign financial institutions including banks, insurance companies and brokerage firms.

Until 1991, the TSE was not open to direct foreign investment. Foreigners could invest in the TSE only indirectly through funds such as the Taiwan Fund and the R.O.C. Fund, both of which are traded on the New York Stock Exchange. As of 1991, foreign institutional investors are permitted direct access to the TSE in the hope that they will bring more sophistication and maturity to the market. Finance Minister Wang Chien-hsien was quoted as "asserting his belief that foreign fund managers would bring a new rationality to Taiwan's often irrational market."²⁴

From January 16, 1991 through November 4, 1991, 16 foreign fund managers have received approval to invest about US\$750 million in the TSE, which is about one third of the US\$2.5 billion in foreign investment authorized by the government. However, the flow of foreign funds into the TSE has been slower than anticipated and slightly less than half the funds have been remitted.²⁵ The major issue slowing the inflow of foreign funds appears to be restrictions on capital flows, i.e., foreign exchange regulations governing the remittance of capital into Taiwan and the repatriation of profits out of Taiwan.²⁶

As the TSE is internationalized and the associated liberalization of the financial services sector progresses, Taiwan should be well-positioned to become a major capital center for Asia, perhaps even challenging Hong Kong by 1997.

24. Jeremy Mark, *The Wall Street Journal*, November 4, 1991.

25. *Ibid.*

26. Several articles in the business pages of the local Chinese press (*Shih Chie Jih Pao*) (World Journal) have made reference to new amendments to the foreign exchange regulations, which are under consideration by the Ministry of Economic Affairs. These amendments are intended to simplify the remittance of capital into Taiwan and the repatriation of profits out of Taiwan. However, the author has not yet been able to obtain any official announcement.

CHAPTER II—THE STATUTE FOR INVESTMENT BY FOREIGN NATIONALS

The Statute for Investment by Foreign Nationals (SIFN)²⁷ was first promulgated on July 14, 1954, and has been amended several times, most recently on May 26, 1989. The Statute sets out the types of investments foreign nationals may engage in, specifies the forms that the investments may take, and entitles foreign investors to several important exemptions and benefits under this and other relevant laws.

In order to qualify for the benefits provided under this Statute, the foreign investor must apply to the Investment Commission (IC) of the Ministry of Economic Affairs for Foreign Investment Approval (FIA).²⁸ The IC consists of members from several government agencies²⁹ and its purpose is to provide "one stop shopping" for the foreign investor. That is to say that, rather than applying separately for approval from each of the various ministries and agencies which may have jurisdiction over some aspect of a proposed investment, the investor may file a single application with the IC to get all the necessary approvals. This greatly simplifies the application process, but the application still requires quite a lot of

27. *Wai Kuo Jen T'ou Tse T'iao Li* (Statute for Investment by Foreign Nationals), promulgated July 14, 1954, last amended May 26, 1989 (Republic of China)(hereinafter cited as *SIFN*). There is also a similar statute which governs investment by overseas Chinese; *Hua Ch'iao Hui Kuo T'ou Tse T'iao Li* (Statute for Investment by Overseas Chinese), promulgated November 19, 1955, last amended 1989, (Republic of China)(hereinafter cited as *SIOC*). Its provisions are virtually identical to those of the *SIFN*. Although this discussion refers to the *SIFN*, it is also applicable to the *SIOC*.

28. *SIFN*, *supra* note 27, Arts. 7 and 8.

29. The members are the:

(1) Vice Minister of Economic Affairs, (2) Vice Minister of Finance, (3) Vice Minister of Foreign Affairs, (4) Vice Minister of Communications, (5) Vice Minister of the Interior, (6) Assistant Director of the Council for Economic Development, (7) Vice Chairman of the Council on Overseas Chinese Affairs, (8) Vice Chairman of the Central Bank of China, (9) Assistant Director of the Executive Yuan National Health Administration, (10) Assistant Director of the Taiwan Provincial Government Development Office, (11) Assistant Director of the Taipei City Government Development Office, and (12) Assistant Director of the Kaohsiung City Government Development Office.

See Kuo, Feng You, *Ch'iao Wai T'ou Tse Shen Ch'ing Shih Wu*, (Overseas Chinese and Foreign Investment Application Practice), Vol. 1, Taipei: Wen Hsin Publishers, 1985, pp. 17-18.

paperwork, all of which must be in Chinese.³⁰ Therefore, local legal representation is usually necessary for the application process.

Once the application is filed with the IC it normally takes about two months to process. The IC's approval policy is now quite liberal³¹ and the IC recently has begun to approve a new form of foreign investment company, the FIA holding company. The FIA holding company offers a flexible investment vehicle that allows foreign investors to diversify their investments in Taiwan by establishing a holding company that can then make different types of investments in various sectors of the economy.³²

The only areas which are off limits to foreign investment³³ are enterprises which;

- a) endanger public safety and security,
- b) violate public morality,
- c) generate unacceptably high levels of pollution, and
- d) those enterprises which are operated by government monopolies³⁴ or in which investment is otherwise regulated by law.

For example, foreign investment in public utilities, financial and insurance institutions, news media and publications, and certain other industries is restricted and requires approval from the relevant authorities.³⁵ For details regarding industries in which foreign investment is restricted, one should examine the Negative List for Investment by Overseas Chinese and Foreign Nationals.³⁶ On the other hand, there are some areas in which foreign investment is particularly encouraged. These include:

30. For a good description of the paperwork required for the IC application including some sample forms (all in Chinese) see *ibid.*, Vol. 1, Chapter 5, Section 1, pp. 164-195.

31. *Doing Business With Taiwan R.O.C.*, 14th ed., China External Trade Development Council (CETRA), June 1991, p. 31.

32. Lawrence S. Liu, "Financial Developments and Foreign Investment Strategies in Taiwan — A Legal and Policy Perspective," *The International Lawyer*, Vol. 25 (Spring 1991), p. 69.

33. *SIFN*, *supra* note 27, Art. 5.

34. For example, tobacco products and alcoholic beverages are controlled by a government monopoly.

35. *Doing Business With Taiwan R.O.C.*, *supra* note 31, p. 31.

36. *Ch'iao Wai T'ou Tse Fu Mien Piao Li-Chin Chih Chi Hsien Chih Ch'iao Wai Jen T'ou Tse Ye Pie Hsiang Mu* (Negative List for Investment by Overseas Chinese and Foreign Nationals) Industrial Development and Investment Center (IDIC), Taipei, August 1991.

- 1) Machinery Manufacturing
 - a) high precision machine tools
 - b) automotive parts and components
 - c) steel molds
 - d) precision forging
 - e) industrial robots
 - f) automatic manufacturing equipment
- 2) Electronics and Information Industry
 - a) computer hardware and software
 - b) telecommunications equipment
- 3) Chemicals
 - a) pharmaceutical manufacturing chemicals
 - b) catalysts
 - c) stabilizers
 - d) surfactant
 - e) other chemicals for industrial uses
- 4) Technical Services
 - a) technical knowledge or patent-right licensing
 - b) technical assistance in plant construction
 - c) design and engineering work
- 5) Other High-tech, Capital-intensive Investments
 - a) high value-added production
 - b) energy efficiency and conservation
 - c) enhanced competitiveness and marketability of products.³⁷

In addition to the benefits of FIA status accorded by the SIFN, foreign investors in these fields of investment should also qualify for other incentives provided for by other applicable laws. (Some of these laws will be discussed elsewhere in this paper.)

Once FIA status is granted by the IC, the SIFN entitles the foreign investor to the following benefits:

- Repatriation in foreign exchange of net profits, or interest accrued from the investment.³⁸
- After one year of operation, repatriation in foreign exchange of the entire amount of the invested principal.³⁹

37. *Doing Business With Taiwan R.O.C.*, *supra* note 31, p.31.

38. *SIFN*, *supra* note 27, Art. 13.

39. *Ibid.*

- Provided that the foreign investor owns at least 45% of the enterprise, the enterprise is exempt from the requirement that its stock be offered to the public or its employees.⁴⁰
- The income tax withholding rate on dividends received by foreign investors is reduced to 20%.⁴¹
- Exemption from provisions of the Company Law regarding nationality of shareholders, directors and supervisors, as well as from the requirements concerning minimum amounts of investment by R.O.C. nationals and employees' subscription rights to new shares.⁴²
- Exemptions from other laws governing specific fields of investment.⁴³
- Guarantee of treatment equal to that accorded to enterprises owned by R.O.C. nationals, i.e., national treatment.⁴⁴
- Provided that the enterprise is at least 45% foreign-owned, it is fully protected against government expropriation for twenty years from the start of the business.⁴⁵
- If the enterprise is less than 45% foreign-owned, the investor "shall be reasonably compensated if the government acquires or expropriates the invested enterprise because of national defense needs. The compensation. . . shall be permitted for outward remittance."⁴⁶(emphasis added).

Compare these provisions to their nearest equivalents in the People's Republic of China. The P.R.C. law provides, "Except

40. *Id.*, Art. 18. The R.O.C. Company Law Art. 156-4 equires that shares be offered to the public; Art. 267 of the Company Law requires that shares be set aside for the employees of the enterprise.

41. See discussion of *SEI*, Art. 16-1 and *SUI*, Art. 11 *infra* note 52.

42. *SIFN*, *supra* note 27, Art. 18. See also, the Company Law Art. 98-1 (domicile and nationality), Art. 108-2 (domicile and nationality), Art. 128-1 (domicile), Art. 208-5 (domicile and nationality), and Art. 216-1 (domicile).

43. *SIFN*, *supra* note 27, Art. 19. Exemptions are provided from the Mining Law, Land Law, Maritime Law and Civil Aviation Law if the foreign investor is approved to invest in these fields.

44. *SIFN*, *supra* note 27, Art. 20.

45. *Id.*, Art. 16.

46. *Id.*, Art. 15.

under special circumstances, the state shall not nationalize or expropriate wholly owned foreign enterprises. Should it prove necessary to do so in the public interest, legal procedures will be followed and reasonable compensation will be made."⁴⁷

Under the R.O.C. law, an enterprise that is 45% or more foreign-owned may not be expropriated at all during its first 20 years of operation. An enterprise with less than 45% foreign ownership may be expropriated only for "national defense needs." Under the P.R.C. law the enterprise must be 100% foreign-owned before it qualifies for any protection at all, and even then it may still be expropriated in the "public interest" under "special circumstances", neither of which is defined in the law.

The R.O.C. law guarantees that foreign exchange remittance of compensation for expropriation will be provided. The P.R.C. law promises only "reasonable" compensation, and gives no definition or standard of reasonableness. Furthermore, the P.R.C. law makes no mention of foreign exchange and presumable, the foreign investor might be compensated in non-convertible (i.e., worthless) currency.

The above discussion should make quite clear that for nearly 40 years, the SIFN has provided strong, fundamental protection to the foreign investor in Taiwan and has helped to make Taiwan a safe and stable place for foreign investment. As the R.O.C. gradually removes its controls on foreign exchange,⁴⁸ the foreign exchange benefits of FIA status eventually will become less important for the foreign investor.⁴⁹ However, even assuming that to be so, it is likely that foreign investors will continue to apply for FIA status because of the confidence they have in the protection it offers them and because FIA status entitles them to benefits under other laws,

47. *Zhong Hua Ren Min Gong He Guo Wai Zi Qi Ye Fa* (*Chung Hua Jen Min Kung He Kuo Wai Tse Ch'i Yeh Fa*) (P.R.C. Law on Enterprises Operated Exclusively With Foreign Capital), § 5, P.R.C. Law, no. 860412, adopted April 12, 1986 (emphasis added.) See also *Guo Wu Yuan Guan Yu Gu Li Tai Wan Tong Bao Tou Zi De Gui Ding*, (*Kuo Wu Yuan Kuan Yu Ku Li Tai Wan T'ung Pao T'ou Tse Te Kui Ting*) (Rules of the State Council on Encouraging Investment by Taiwan Compatriots), P.R.C. Rule, no.880703 adopted July 3, 1988. Article 8 provides; "The state shall not nationalize the investment and assets of Taiwan investors." However, Article 9 provides; "Where the state is to nationalize any Taiwan compatriots investment enterprise pursuant to the needs of public welfare, the state shall grant relevant compensation in accordance with legal procedures." What is given with one hand is taken away with the other.

48. As mentioned *supra* at note 26, foreign exchange regulations are currently being amended.

49. Liu, *supra* note 32.

such as the investment incentives offered by the SUI, discussed below.

CHAPTER III—THE STATUTE FOR ENCOURAGEMENT OF INVESTMENT (SEI)⁵⁰

For the past thirty years, the Statute for Encouragement of Investment (SEI) has provided the fundamental statutory basis for investment credits, tax incentives, acquisition of land for industrial use, and coordination between private enterprises and publicly operated enterprises. As mentioned above,⁵¹ the SEI recently expired and was replaced by a new statute, the Statute for Upgrading Industries (SUI),⁵² which offers a modified program of investment incentives better geared to Taiwan's modern economic situation and development needs. Although the SEI now has been superseded by the SUI, it was the SEI which helped to build Taiwan's economy. The SUI may be seen as an updated, "higher-tech" version of the SEI, intended to take Taiwan's now developed economy into the future. In order to understand the SUI and the policies behind it, it is necessary to understand the SEI and its policies. Therefore, the SEI should be considered first.

The SEI consists of five chapters; General Provisions; Tax Benefits; the Acquisition of Land for Industrial Use; the Coordination of Public-Operated Enterprises with Private Enterprises; and Supplemental Provisions. A complete and detailed examination of all the provisions of these five chapters would be quite lengthy. Because the purpose of this paper is to examine the role of the legal system in the development of Taiwan's economy and the opportunities for foreign investors in Taiwan, this discussion of the SEI will concentrate on Chapter II, Section 1, which contains the tax benefits for encouragement of investment. These provisions are the most relevant to foreign investors, and also the most important for stimulating economic growth and development. The other sections of the SEI will be discussed only briefly and in less detail. Although the SEI has expired, it will be discussed in the present tense for purposes of clarity.

50. *SEI*, *supra* note 18.

51. See note 18 *supra*.

52. *Tzu Chin Ch'an Yeh Sheng Chi T'iao Li* (The Statute for Upgrading Industries), promulgated December 28, 1990 (Republic of China) (hereinafter cited as *SUI*).

I. SEI CHAPTER I: GENERAL PROVISIONS

The Purpose and Flexible Application of the SEI

The SEI was first promulgated on September 10, 1960, "for the purpose of encouraging investment and accelerating economic development."⁵³ The basic policy of the SEI is quite simple; it is the belief that entrepreneurial activity will be stimulated and capital will flow to the targeted sectors of the economy if incentives such as tax benefits are offered to encourage productive investments.

The SEI always has been flexible. It was amended fifteen times during its thirty year history in order to adapt its provisions to the changing needs of Taiwan's rapid economic development. Its provisions are flexible to allow it to apply to "all matters concerning the encouragement of investment." Additionally "any such matters not provided for in this Statute shall be governed by . . . other relevant laws, provided that . . . the most favorable provisions shall apply."⁵⁴ Thus, the SEI itself provides that in the case where some other applicable law offers more favorable treatment, the more favorable provisions will apply.

Some types of enterprises are governed by specific laws, the provisions of which may offer additional benefits and/or may impose additional requirements in order to qualify for benefits under the SEI.⁵⁵ In such a case it is important to determine how the SEI "dovetails" with other interrelated relevant laws governing the specific type of enterprise. When an enterprise complies with the relevant laws governing that specific type of enterprise, it is entitled to the benefits of those laws, and also to any additional benefits available under the SEI.⁵⁶ This gives the investor a greater range of potential incentives.

Requirements to Qualify for Benefits Under the SEI

The most fundamental and important requirement in order to qualify for benefits under the SEI is that the enterprise must be organized under the R.O.C. Company Law as a "company limited

53. *SEI*, *supra* note 18, Art. 1.

54. *Id.*, Art. 2.

55. For example, a special regulation governs venture capital enterprises. In order for a venture capital enterprise to qualify for benefits under the SEI it must first comply with the requirements of the *Regulations Governing Venture Capital Enterprises*.

56. For example, see *SEI*, *supra* note 18, Art. 15 which provides an additional tax incentive for certain specific types of enterprises including venture capital enterprises and capital or technology intensive enterprises.

by shares".⁵⁷ The company limited by shares is the R.O.C.'s nearest equivalent to the corporation under U.S. law and is the preferred form of business organization most encouraged by the R.O.C. government.⁵⁸

If the enterprise is a foreign company, there are two further requirements.⁵⁹ It must be organized under foreign law in a corporate form equivalent to the company limited by shares (i.e., as a corporation), and must have FIA status according to the SIFN, as discussed above.

The last requirement is that the company, foreign or domestic, must be a "productive enterprise".⁶⁰ As defined by Article 3 of the SEI, a "productive enterprise" produces goods and/or services in one of the following areas: (1) Manufacturing, (2) Handicraft, (3) Mining, (4) Agriculture, (5) Forestry, (6) Fishery, (7) Animal Husbandry, (8) Transportation, (9) Warehousing, (10) Public Utility, (11) Public Facility Construction and Development, (12) Public Housing Construction, (13) Technical Services, (14) Hotels, and (15) Heavy Machinery Construction.⁶¹

This list of "productive enterprises" makes quite clear the economic policies behind this requirement, i.e., that the R.O.C. government considers these sectors important for national economic growth and therefore has targeted them for rapid development.

As these fifteen categories are quite broad, the SEI further provides that the "respective categories and criteria of encouragement for the different operations specified . . . shall be prescribed and promulgated by the Executive Yuan" (the Cabinet).⁶² Specific regulations which further define and clarify the scope of the fields of the various "productive enterprises" are issued and periodically reviewed and updated by the Executive Yuan.⁶³ In issuing regula-

57. *SEI*, *supra* note 18, Art. 3.

58. The R.O.C. Company Law provides for several forms of business associations which may be compared to the business associations recognized under U.S. laws. For details regarding the company limited by shares, see The R.O.C. Company Law, especially Chapter Five.

59. *SEI*, *supra* note 18, Art. 3.

60. *Ibid.*

61. *Ibid.*

62. *Ibid.*

63. See *Sheng Ch'an Shih Yeh Chiang Li Lei Mu Chi Piao Chün* (Categories and Criteria of Encouragement for Productive Enterprises), last amended 1986, expired May 3, 1991. (Executive Yuan, Republic of China).

tions, guidelines and procedures,⁶⁴ the Executive Yuan consults with the specific ministries and/or agencies which have jurisdiction over the specific types of enterprise(s). This allows regulations to be updated and tailored to fit the changing needs of the various sectors of the economy, thus adding even greater flexibility to the application of the SEI.

It is interesting to note that the new statute which has now replaced the SEI, the SUI, does not use the "productive enterprises" language. Rather than providing incentives based primarily on manufacturing production criteria, the SUI offers incentives to a wider range of enterprises based on activities such as the purchase of machinery and equipment, research and development expenditures, marketing efforts to develop brand name recognition and personnel training. The SUI will be discussed further below and is mentioned here only for the sake of comparison.

II. SEI CHAPTER II: TAX BENEFITS

The various tax benefits provided under Chapter II are really the most important provisions of the SEI, particularly for the foreign investor, as tax benefits provide strong incentives for productive investments. The requirements to qualify for the tax benefits direct such investments into the sectors of the economy that are targeted by government policy for development.

1. Section 1: Tax Benefits for Encouragement of Investment

Newly Established Enterprises

A newly established enterprise which meets the criteria discussed above may choose either a five year exemption from the profit seeking enterprise income tax,⁶⁵ or accelerated depreciation of its fixed assets.⁶⁶

If the enterprise chooses the five year tax exemption the tax holiday begins on the date when the enterprise begins to market its

64. For example, the "Important Productive Enterprises", "Strategic Enterprises" and "Technology/Capital Intensive Enterprises" are specified by the Executive Yuan. For a partial list of some of these regulations, see Appendix 1.

65. This tax is part of *Suo Teh Shui Fa* (The Income Tax Law)(1943), last amended 1989 (Republic of China). Under this law the income tax is divided into the *Ying Li Suo Teh Shui* (Profit Seeking Enterprise Income Tax), which is the "corporate" income tax, and the *Tsung He Suo Teh Shui* (Consolidated Income Tax), which is the "individual" income tax.

66. *SEI*, *supra* note 18, Art 6 ¶ 1.

products or render services, and the enterprise must depreciate its fixed assets according to the provisions of the income tax law.⁶⁷

If the enterprise chooses the accelerated depreciation option,⁶⁸ the service lives of machinery and equipment provided under the income tax law may be accelerated by one half.⁶⁹ Similarly, the service lives of buildings, constructions, facilities and communication and transportation facilities provided under the income tax law may be accelerated by one third.⁷⁰

Expansion/Capital Increase by Existing Enterprise

When an enterprise that meets the criteria for encouragement “effects an expansion of equipment through increase of capital for production or rendition of services,”⁷¹ it also has a choice of either a tax holiday or accelerated depreciation.

In this case, eligibility for the four year (one year less than under the above section) tax exemption is limited to an “increase of capital for additional establishment of independent production or service units, or for expansion of major production or service units,”⁷² provided that the expansion has been “approved by the authority in charge of the enterprise,”⁷³ and the exemption applies only to “the increased income derived as a result of such expansion”.⁷⁴ The tax exemption begins on the date that the newly added equipment begins to operate or render services and the equipment must be depreciated according to the service life provided under the income tax law.

The accelerated depreciation option is the same as that accorded to newly established enterprises under the preceding section.⁷⁵

67. *Id.*, Art. 6 ¶ 1-1.

68. *Id.*, Art. 6 ¶ 1-2.

69. *Id.*, Art. 6 ¶ 1-2-1.

70. *Id.*, Art. 6 ¶ 1-2-2.

71. *Id.*, Art. 6 ¶ 2.

72. *Id.*, Art. 6 ¶ 2-1.

73. *Id.*, Art. 6 ¶ 3.

74. *Id.*, Art. 6 ¶ 2-1.

75. *Id.*, Art. 6 ¶ 2-2.

Deferral of Tax Exemption Period

An additional incentive is available for capital-intensive or technology-intensive enterprises⁷⁶ which select one of the above tax exemptions. The beginning of the tax exemption period may be deferred for up to four years from the date on which the enterprise begins to market products or render services.⁷⁷

Capital or technology intensive enterprises often have high start-up costs and relatively long-term development plans. It may take some time before such an enterprise becomes profitable. Since an income tax exemption would not be very useful to a firm which was not generating a profit, the ability to defer the beginning of the tax holiday until the firm becomes profitable could be an important benefit.

Incentives for Venture Capital and Overseas Investment

The tax holiday provided under Article 6 and the deferment provided under Article 7 are also available to a venture capital investment enterprise⁷⁸ or other profit-seeking enterprise which is organized as a company limited by shares and which invests in foreign countries in any of the following activities:⁷⁹

- 1) The exploration, development or processing of natural resources and shipment of the products thereof back to the R.O.C.;
- 2) The production or processing of agricultural or industrial raw materials specifically identified by the government for sale in foreign or domestic markets;
- 3) Transfer back to the R.O.C. of technologies identified by the R.O.C. government; and
- 4) Investment in other enterprises specifically identified by the R.O.C. government and sale of the products thereof in foreign or domestic markets.

76. The scope of enterprises which qualify as capital-intensive or technology-intensive is established by the *Categories and Criteria of Encouragement for Productive Enterprises*. See also note 63 *supra*, other related regulations and Appendix 1.

77. *SEI*, *supra* note 18, Art. 7.

78. To qualify as a "venture capital investment enterprise" the enterprise must be established according to the *Regulations Governing Venture Capital Enterprises*. See note 55 *supra*.

79. *SEI*, *supra* note 18, Art. 8 ¶ 1.

The applicable scope and measures relating to the assistance and administration of these enterprises shall be promulgated by the Executive Yuan.⁸⁰

Investment in Construction of the Taipei World Trade Center

The tax holiday provided under Article 6 and the deferment provided under Article 7 also were made available to companies that invested in the construction of the World Trade Center complex in Taipei pursuant to the government plan for the development of the center.⁸¹

Transferability of Incentives

If, during the period in which an enterprise is entitled to the tax exemption discussed above, the enterprise sells its business, or sells all of its equipment which is entitled to the tax exemption, to another enterprise which qualifies for incentives under the Categories and Criteria of Encouragement,⁸² the acquirer is entitled to continue to enjoy the unexpired portion of the original incentive.⁸³

Investment Tax Credit

Within the scope of Executive Yuan policy, a productive enterprise may be permitted an investment tax credit of five to twenty-five percent of the amount invested in production equipment. This credit may be taken against the Profit Seeking Enterprise Income Tax⁸⁴ due for the current year. Where the amount of the available credit exceeds the amount of tax due in the current year, the balance of the credit may be carried forward for up to five years. However, except for the last year, the credits applied in each of the carry forward years may not exceed fifty percent of the tax due that year.⁸⁵

Accelerated Depreciation for Renovation of Production Equipment

Pursuant to special approval by the concerned authorities, a productive enterprise which renovates its machinery or equipment

80. *Id.*, Art. 8 ¶ 2.

81. *Id.*, Art 8-1.

82. See note 63 *supra*.

83. *SEI, supra* note 18, Art. 9.

84. See note 65 *supra*.

85. *SEI, supra* note 18, Art. 10.

to increase capacity may accelerate the service life of the machinery or equipment provided under the tax laws by one half.⁸⁶

Tax Incentive for Shareholders in Productive Enterprises

Where an enterprise issues new shares to its shareholders representing the re-investment of undistributed earnings for any of the reasons below, the value of the newly issued shares will not be included in the shareholder's⁸⁷ taxable income for the current year.⁸⁸

- 1) "To add or renovate machinery and equipment or transportation facilities for use for production of goods, rendition of services, research and development, quality inspection, prevention of pollution, conservation of energy, elevation of the standard of industrial safety and hygiene"⁸⁹
- 2) To repay a loan or account payable incurred for any of the reasons stated in subparagraph (1) above.
- 3) Other re-investment according to the criteria prescribed under Article 20 of this law.

The above provisions also apply to employees who receive shares of their employer by re-investing their bonuses in a capital increase.⁹⁰

Venture capital enterprises which increase their capital by re-investing their undistributed earnings may also take advantage of these provisions.⁹¹ Branch offices of foreign firms which re-invest R.O.C. earnings as R.O.C. working capital also may use these provisions to exclude the re-invested amount from their R.O.C. source income.⁹²

86. *Id.*, Art. 12.

87. In the case of an individual shareholder this exemption applies to the Individual Income Tax. In the case of a corporate shareholder it applies to the Profit Seeking Enterprise Income Tax. Thus, this is both a corporate and an individual incentive.

88. *SEI, supra* note 18, Art. 13.

89. *Id.*, Art. 13 ¶ 1-1.

90. *SEI, supra* note 18, Art. 13 ¶ 2. This provision illustrates one way in which all productive members of society benefit from these incentives. This provision benefits shareholders and workers alike, each of whom receive similar treatment for similar activity, namely productive, long term investments. Compare this provision to some of the political rhetoric that comes out of Washington, D.C. with reference to "fairness" and tax measures proposed to "stimulate the economy."

91. *SEI, supra* note 18, Art. 13 ¶ 3.

92. *Id.*, Art. 13 ¶ 4.

However, if the shares subsequently are transferred, they will be valued at their full market value at the time of the transfer and the income received will be deemed income of the year of the transfer. This provision discourages abuse of these shares for "short-swing profits" or undue speculation.

Limitation for New Equipment

In order to qualify for the incentives under Articles 5, 12 and 13 discussed above, the machinery and/or equipment purchased must be entirely new. A limited exception is made if the equipment is purchased from domestic sources and the portion of used equipment does not exceed five percent of the total value of the equipment, or if the equipment is purchased from abroad due to "actual need" and with the approval of the authority in charge.⁹³

Reduction of Profit Seeking Enterprise Income Tax Rates

The maximum profit seeking enterprise income tax rate for productive enterprises which qualify for encouragement is reduced to twenty-five percent. For particularly encouraged enterprises⁹⁴ the maximum rate is further reduced to twenty percent.⁹⁵

Reduction of Withholding Rate for Non-Residents

Passive R.O.C. source income⁹⁶ distributed by a non-FIA enterprise to a non-resident of the R.O.C. is subject to a thirty-five percent withholding rate.⁹⁷ For enterprises with FIA status the withholding rate is reduced to twenty percent.⁹⁸ In cases where the amount withheld exceeds the amount of tax due, the taxpayer may file an income tax return according to the Income Tax Law to apply for a refund.⁹⁹

93. *Id.*, Art. 14.

94. These include venture capital enterprises, big trading companies, basic metals production industries, heavy machinery industries, petrochemical industries, enterprises which are capital and/or technology intensive, industries which are necessary for economic development and development of national defense and other important technology based enterprises designated by the government. The scope of these enterprises is prescribed by regulations issued by the Executive Yuan.

95. *SEI*, *supra* note 18, Art. 15.

96. Corporate dividends or partnership profits earned in the R.O.C. and distributed to non-residents of the R.O.C.

97. *SEI*, *supra* note 18, Art 16 ¶ 1-2.

98. *Id.*, Art. 16 ¶ 1-1.

99. *Id.*, Art. 16 ¶ 2.

These provisions apply to both individual and corporate investors. They also apply to a non-R.O.C. resident who is a director a supervisor or a managerial officer of an enterprise with FIA status who resides in the R.O.C. for more than 183 days¹⁰⁰ in a tax year for the purpose of managing the enterprise.¹⁰¹

Foreign Investor's Salary Not Treated as Taiwan Source Income

Remuneration paid outside of Taiwan to foreign nationals who reside in Taiwan for less than 183 days in a tax year for the purposes of establishing operations of an enterprise with FIA status is specifically deemed non-R.O.C. source income.¹⁰² This income is thus protected from R.O.C. tax liability.

Exemption for Venture Capital Enterprises

Earnings of venture capital enterprises which are derived from transactions on the securities exchange and distributed to the venture capital enterprises' investors are exempt from income tax during periods when the securities exchange income tax is suspended.¹⁰³

Exemption from Company Law Limitations on Investment

Normally, the amount of a profit seeking enterprise's investment(s) in other companies is limited to a maximum equal to the amount of forty percent of the investing enterprise's paid-in capital.¹⁰⁴ Providing that proper authorization is obtained from the shareholders, this limitation is waived for venture capital enterprises and other technology based enterprises designated by the government.¹⁰⁵

100. Under R.O.C. tax laws, a person who spends more than 183 days in a tax year in the R.O.C. may be treated as a resident for tax purposes. See *The Income Tax Law*, *supra* note 65, Art. 7.

101. *SEI*, *supra* note 18, Art. 17.

102. *Id.*, Art. 18.

103. *Id.*, Art. 16-1. The "capital gains" type tax on income from securities transactions has been imposed and suspended at various times depending on whether the government wanted to encourage trading or try to cool down an overheated market. See note 22 *supra*.

104. See R.O.C. Company Law, Art. 13.

105. *SEI*, *supra* note 18, Art. 16-2.

Tax Exemption for Corporate Investment in Venture Capital Enterprises

Where an enterprise organized as a company limited by shares which invests in a venture capital enterprise, eighty percent of the income derived from that investment is excluded from the taxable income of the company.¹⁰⁶

Incentive for Contribution of Land to Productive Enterprises

Under R.O.C. law, when land is transferred, a tax is levied on the appreciated value of the land.¹⁰⁷ This tax is normally due in a lump sum payment. However, where land is transferred as an investment into a productive enterprise, the tax may be paid in five equal annual installments rather than one lump sum payment. Until the tax is paid, payment must be secured by either the land itself or shares of the enterprise which acquired the land.¹⁰⁸

The deed tax imposed on real property is also reduced to half the statutory rate in the case of real property used by a productive enterprise.¹⁰⁹

Tax Incentive for Original, Long-Term Individual Investors

An individual who subscribes to registered shares of a qualifying enterprise¹¹⁰ at their original issue and holds the shares for three years is entitled to deduct up to fifteen percent of the price of the shares from their consolidated income tax¹¹¹ due the third year.¹¹²

Tax Incentive for Investment in High-Technology

Individuals and profit seeking enterprises who subscribe to or underwrite the original issue of shares by an "important technology based enterprise"¹¹³ may take a current year deduction of up to thirty percent of the price paid for the shares. In the event that the deduction exceeds the amount of tax due it may be carried forward

106. *Id.*, Art. 16-3.

107. The tax is known as the land value increment tax or land appreciation tax.

108. *SEI, supra* note 18, Art. 19.

109. *Id.*, Art. 22.

110. As prescribed by the Executive Yuan. See notes 63 and 64.

111. See note 65.

112. *SEI, supra* note 18, Art. 20.

113. As prescribed by the Executive Yuan. See notes 63 and 64.

for five years. In all but the last year, the deductible amount may not exceed fifty percent of the amount of tax due.¹¹⁴

It should be noted that this particular incentive is not available to venture capital enterprises because they specialize in the business of making this type of investment. Venture capital enterprises are required to invest in high-technology areas and are offered other incentives under both the SEI and the Regulations Governing Venture Capital Enterprises.

Incentive for Investment in Venture Capital Enterprises

Individuals and profit seeking enterprises who subscribe to or underwrite the original issue of shares by a venture capital enterprise may take a current year deduction of up to twenty percent of the price paid for the shares. As in the above section, the deduction is limited to fifty percent of the tax due, and a five year carry forward is provided. However, the amount to be deducted in each year is determined by a ratio between the venture capital enterprise's current year investments in technology based enterprises and its paid-in capital.¹¹⁵

Incentives Related to Duties on Importation of Equipment

Productive enterprises which, with the approval of the authorities in charge, import machinery, equipment, materials or component parts which are not yet domestically manufactured, may be permitted to pay the necessary import duties in installments beginning one year after the equipment becomes productive, rather than in a lump sum due at the time the equipment is imported.

With proper approval, some industrial, mining or other particularly encouraged enterprises may be exempt completely from import duties. However, there is a limitation imposed: if the equipment is later transferred to non-qualifying enterprise, or if the qualifying enterprise subsequently reduces its capital, the exempt duties will be reassessed.

Approved imports of domestically unavailable instruments and equipment for certain very highly encouraged activities¹¹⁶ are ex-

114. *SEI*, *supra* note 18, Art. 20-1.

115. *Id.*, Art. 20-2.

116. Including research and development, experimentation, development of new products, quality inspection, improvement of quality, energy conservation, pollution prevention and waste utilization.

empt from import duties without any provision being made regarding subsequent reassessment of the duties.¹¹⁷

Measures governing the details of exemption from and installment payment of import duties are issued by the Ministry of Finance.¹¹⁸

2. Section 2: Tax Benefits for Encouragement of Savings and Promotion of the Development of the Capital Market

As mentioned in the introduction to this paper, Taiwan has one of the world's highest personal savings rates, as high as forty percent of GNP.¹¹⁹ This high savings rate is partially attributable to the fact that the people of Taiwan traditionally have been thrifty, particularly the generation which still remembers wartime and post-war poverty.¹²⁰ It also is attributable partially to R.O.C. government policies that have encouraged savings so as to create a pool of available domestic capital, which may be directed into productive investments to fuel economic development.

Once this pool of capital is available, a capital market becomes necessary to direct the funds into productive investments efficiently. As may be seen from the brief mention of the Taiwan Stock Exchange (TSE) above, the R.O.C. has been only partially successful in developing efficient capital markets. Improvement of the capital markets is one of the major priorities for Taiwan in the 1990s.

Many businesses in Taiwan traditionally have raised capital from sources other than banks or the stock market. Some examples

117. *SEI*, *supra* note 18, Art. 21.

118. *Sheng Ch'an Shih Yeh Shu Ju Chi Ch'i She Pei Fen Chi Chiao Na Chi Mien Cheng Chin Kou Shui Chuen Shih Pan Fa* (Regulation for Installment Payment or Exemption of Import Duties For Productive Enterprises Importation of Instruments and Equipment)(1988), Ministry of Finance (Republic of China).

119. By contrast, the U.S. savings rate is currently less than 3% of GNP. Clearly, our low savings rate is directly related to our lack of investment. This compounds the problem that was mentioned above, i.e., that our tax laws do not encourage investment. Furthermore, due to our national debt, (productive) private sector investors must compete with the (non-productive) federal government for what little investment capital is available. These factors may have something to do with our current deteriorating economic situation and our lack of international competitiveness.

120. This situation has changed a bit in recent years. As mentioned above in the discussion of the "boom years" of economic growth beginning in the mid-1980s, there is now a large market in Taiwan for expensive luxury goods and there has been a trend toward more conspicuous consumption. However, the savings rate remains very high and these current trends are likely just signs of Taiwanese enjoyment of the wealth they have worked so hard to build.

of these sources include rotating credit clubs based on family and social ties,¹²¹ informal lending between businesses,¹²² employee deposit taking by businesses, and underground or informal lending by otherwise regulated entities.¹²³ There are many reasons for these practices.¹²⁴ Some are due to cultural or traditional business practices, other reasons are to avoid the difficulties imposed by a highly regulated financial sector. As Taiwan continues to liberalize, modernize and internationalize the financial services sectors, it will be interesting to see how these traditional practices change and adapt to the new economic environment.¹²⁵

Chapter II Section 2 of the SEI offers incentives to encourage both savings and the development of the capital markets.

Incentives for Individual Savings

Various forms of long-term savings are encouraged by exempting the interest earned from taxation when they are held for the required period and up to a specified maximum amount. These include ordinary pass-book savings accounts, short-term commercial paper, treasury bonds, corporate bonds, financial bonds, trust fund savings income and dividends on registered shares publicly issued by listed companies.¹²⁶

Incentives for Taking Companies Public

A company that publicly lists its shares on the market in the form of registered shares may reduce its corporate tax for that year by fifteen percent.¹²⁷ If shares are issued above par value and the

121. Known as *hui* in Chinese, these groups are common in Chinese and several other East Asian cultures.

122. A long term relationship is sometimes established between businesses through borrowing from suppliers, customers and related companies.

123. For example, under the R.O.C. Banking Law, interest rates have been regulated and there are strict requirements regarding such things as collateral requirements and terms of long-term loans. This has made it quite difficult for many smaller businesses to obtain bank loans.

124. For discussion of some of these issues see generally Jane Kaufman Winn, "Banking and Finance in Taiwan", *The International Lawyer*, Vol. 25 (Winter 1991), p. 907.

125. Alternative sources of credit, the burdensome regulatory structure of the financial services sector and the "underground" sectors of the economy are among other subjects of the new economic environment.

126. *SEI*, *supra* note 18, Art. 23.

127. *Id.*, Art. 24.

gain realized is set aside as a reserve,¹²⁸ the amount of the gain is deductible from the year's taxable income.¹²⁹

Capital Gains from Sale of Shares or Bonds

When certain shares or bonds which have been held for more than one year are sold one half of the gain realized is taxed as ordinary income for the year of the sale and the other half of the gain is exempt from income tax.¹³⁰

Suspension of Securities Exchange Tax and Exemption from Stamp Tax

The Executive Yuan has the discretion to temporarily suspend the securities exchange tax for persons who are not in the business of trading securities as their profession.¹³¹ Documents necessary for securities transactions such as contracts, slips and receipts are exempt from the stamp tax.¹³²

3. Section 3: Tax Benefits for Encouragement of Export Business

When the SEI was promulgated originally in 1960, this section contained five articles. As discussed above, this was at the beginning of the period of export expansion when exports were particularly encouraged through various measures such as export processing zones and bonded warehouses. Obviously, these measures were quite successful, it is well known that the bulk of Taiwan's economic development has been export driven. However, over the years Taiwan became such a successful export power that many of the incentives that had been used to promote exports were no longer necessary and were therefore amended and reduced.

As the SEI was amended, several of the articles in this section were deleted, until finally only two of the five articles in this section remained. The remaining provisions merely allowed a reserve for

128. This is in accordance with the Company Law.

129. *SEI, supra* note 18, Art. 25.

130. Compare the U.S. treatment of capital gains tax. The gain realized is taxed at a higher rate than ordinary income, no portion of the gain is exempt from taxes (regardless of the fact that the total gain may represent only inflation), and the entire issue is treated as nothing more than a "political football."

131. *SEI, supra* note 18, Art. 27. See also notes 22 and 103 *supra*.

132. Many legal documents must be registered with the government and a seal affixed. Of course a fee is charged for affixing the seal, i.e., The Stamp Tax. *Yin Hua Shui Fa* (The Stamp Tax), last amended 1986 (Republic of China).

export loss to be set aside in the amount of one percent of the export exchange settlement for the previous year,¹³³ and provided an exemption from the stamp tax for agreements for building, inspection or repairing ships and airplanes operating on international routes.¹³⁴

4. Section 4: Tax Benefits for Encouragement of Research and Development

Research and development activities are essential to long-term economic growth. Existing products must be upgraded and new products must be developed in order to keep up with competition in the market place.¹³⁵ Early success or even dominance does not guarantee future competitiveness.¹³⁶

However, research and development projects require significant current investments, which usually will not begin to pay any dividends until some, often undetermined, future time. Successful research and development requires the ability to take short-term financial risks and the patience to forgo quick returns and wait for long-term results.

It is essential that corporate management be able to take this long-term view, and it is also helpful if government policy-makers share this view. Management must work for the long-term profitability and competitiveness of the company rather than just for good quarterly financial statements or daily share price quotes. Government policy should likewise put the country's long-term economic growth ahead of short-term tax revenues or purely political concerns. By encouraging research and development activities through tax incentives, the government is making a long-term investment in the nation's future economic health. Taiwan has made this investment through the SEI, and the new SUI puts even more emphasis on research and development.

133. *SEI*, *supra* note 18, Art. 31.

134. *Id.*, article 32.

135. An example of a Taiwanese company rising to this challenge is illustrated by the story of a certain clothing exporter. Having begun as a typical labor intensive, low technology textile business, the company could not remain competitive in the face of appreciation of the NT\$, rising labor costs and increased competition from lower wage countries. The challenge was met by installation of advanced technology, which reduced labor costs and also allowed the company to move "up-market." Production was switched from inexpensive clothing exported to the likes of Sears and K-Mart, to high quality, expensive, "designer" labels. This high value added production allowed the company to stay competitive in what would otherwise be a declining industry.

136. Consider the condition of the U.S. automobile industry as an example.

Tax Deduction for Research and Development Expenses

Expenditures for research and development and for improving production technology or development of new products may be deducted from taxable income for the current year. Equipment used for research, development, experiments and quality inspection may be depreciated according to the accelerated depreciation provisions in Article 6 discussed above.¹³⁷

According to rules promulgated by the Executive Yuan,¹³⁸ in a year in which research and development expenses exceed the highest amount of research and development expenses for the past five years, an additional tax credit of twenty percent of the excess amount may be taken. The amount of the credit may not exceed fifty percent of the tax due and if the credit exceeds the amount of tax due, the remaining credit may be carried forward for five years.¹³⁹

Government Support of Research and Development and Establishment of Research and Development Fund

The Executive Yuan will establish and administer a research and development fund¹⁴⁰ and will promulgated measures for assistance and guidance of research and development.¹⁴¹

Income Earned Through Exploitation of R.O.C. Patent Rights Exempt from Income Tax¹⁴²

Where an R.O.C. national holds an R.O.C. patent, income earned from licensing or sale of the patent right to a productive enterprise is exempt from income tax.¹⁴³

137. *SEI*, *supra* note 18, Art. 34.

138. *Sheng Ch'an Shih Yeh Yen Chiu Fa Chan Fei Yung Shih Yung T'ou Tse Ti Chien Pan Fa*, (Rules Governing the Application of Tax Deduction for Investment by Productive Enterprises for Research and Development Expenses) promulgated 1985, expired April 24, 1991. (Executive Yuan) (Republic of China).

139. *SEI*, *supra* note 18, Art. 34-1.

140. *Id.*, Art. 35.

141. *Id.*, Art. 37.

142. Note this special encouragement for the development and exploitation of patentable inventions. Inventors, scientists and engineers are not only encouraged to develop new patents, but also are encouraged to become entrepreneurs by productively exploiting their patent rights.

143. *SEI*, *supra* note 18, Art. 36.

5. Section 5: Tax Benefits for Promoting Reasonable Operation and Management of Enterprises

Reasonable operation and management means encouraging certain corporate activities, which may make an enterprise more profitable, competitive or successful. For example, mergers or consolidations of enterprises can result in a stronger combined enterprise. Land use (zoning) regulations may require an enterprise to relocate or enterprises may be encouraged to move their production facilities to specified areas such as industrial parks. While various business activities may be profitable in the long-term, they require significant short-term costs. If these costs can be reduced, then businesses will be encouraged to take these steps and, the economy ultimately will enjoy the benefit of stronger business enterprises.

Reduction of Tax Liabilities Incident to Mergers

In the course of a corporate merger or consolidation, various tax liabilities will be incurred. For example, various documents will create stamp tax liabilities, transfers of land will create land value increment tax and deed tax liabilities. These tax burdens are eliminated and/or reduced for mergers that have been specifically approved by the Ministry of Economic Affairs.¹⁴⁴ After an approved merger, the resulting enterprise may qualify¹⁴⁵ for a fifteen percent income tax reduction for two years following the merger.¹⁴⁶

Reduction of Tax Liabilities Incident to Relocation of Production Facilities

If, for any of the following reasons, an enterprise relocates its factory to a designated industrial district and then sells or transfers its original factory site, the land value increment tax will be assessed at the lowest applicable tax rate. The reasons for this treatment are: (1) the original site does not conform to new zoning regulations; (2) the original site does not meet pollution control or other environmental needs approved by the authority in charge; or, (3) the government initiated the move.¹⁴⁷

144. *Id.*, Art. 38.

145. Qualification is according to criteria prescribed by the Executive Yuan.

146. *SEI*, *supra* note 18, Art. 40.

147. *Id.*, Art. 39.

Enterprises Permitted to Retain Earnings

Under R.O.C. tax laws, where a company retains profits in an amount exceeding one half of its retained earnings, the tax authorities may deem the profits distributed to shareholders and assess income tax on the deemed distribution.¹⁴⁸ However, under the SEI, encouraged enterprises are permitted to retain earnings without tax penalties.

A company may withhold earnings in an amount up to one half of its paid-in capital. A productive enterprise¹⁴⁹ may retain up to an amount equal to its paid-in capital. An "Important Productive Enterprise"¹⁵⁰ or an enterprise within the "Applicable Scope of the Strategic Industries"¹⁵¹ may withhold earnings up to an amount equal to twice their paid-in capital.¹⁵²

Reserve for Foreign Currency Debts

A productive enterprise which incurs a foreign currency debt for the purchase of production machinery and equipment may set aside a reserve in local currency of up to seven percent of amount of outstanding debt.¹⁵³

A financial institution which incurs a foreign currency debt and reloans the money borrowed to a productive enterprise may also utilize this provision.¹⁵⁴

Revaluation of Assets in the Event of Severe Inflation

With the approval of the Ministry of Finance and the authority in charge, and according to regulations prescribed by the Executive Yuan, and enterprise may revalue its assets without being taxed on their appreciation if the Taiwan wholesale price index exceeds the index of 1961 or that of the year in which the assets were last valued.¹⁵⁵

148. *Income Tax Law*, *supra* note 65, Art. 76-1.

149. As provided by *SEI*, *supra* note 18, Art. 3.

150. Such an enterprise is specified by the Executive Yuan. See note 64.

151. *T'se Lüe Hsing Kung Yeh Chih Shih Yung Fan Wei* (Applicable Scope of the Strategic Industries), promulgated June 1988, expired April 24, 1991. (Executive Yuan) (Republic of China)

152. *SEI*, *supra* note 18, Art. 41.

153. *Id.*, Art. 43.

154. *Id.*, Art. 43.

155. *Id.*, Art. 42.

6. Section 6: Tax Benefits for Acquisition of Land for Industrial Use

Some tax exemptions or reductions may apply where agricultural land is transferred to industrial use according to government industrial policies.¹⁵⁶

7. Section 7: Other Tax Benefits

Energy Conservation

Energy conservation equipment purchased with proper approval from the relevant authority may qualify for accelerated depreciation on a two-year service life.¹⁵⁷

Pollution Control

Pollution control equipment also may be depreciated under an accelerated two-year service life.¹⁵⁸

Reduction of Real Property Taxes in Industrial Zones

Taxes due on the sale of factories constructed in designated industrial district are waived and other real property taxes on leases on industrial properties are waived in the first year and then reduced on a sliding scale in subsequent years.¹⁵⁹

The real property tax on international tourist hotels is reduced by one half.¹⁶⁰ Property that is part of the World Trade Center Construction Project is exempt from the real property tax.¹⁶¹

III. SEI CHAPTER III: ACQUISITION OF LAND FOR INDUSTRIAL USE

Under the detailed provisions of this Chapter, the government will first acquire and designate land for industrial use, and then sell or lease that land to entrepreneurs. For purposes of this paper only a few of the most important features of this Chapter will be pointed out here.¹⁶²

156. *Id.*, Arts. 44 and 45.

157. *Id.*, Art. 46.

158. *Id.*, Art. 47.

159. *Id.*, Art. 48.

160. *SEI*, *supra* note 18, Art. 48-1.

161. *Id.*, Art. 18-2.

162. A detailed discussion of R.O.C. property law and Chapter III of the *SEI* is not the subject of this paper, which focuses more on financial incentives.

The Statute requires that the owners of land requisitioned by the government be given fair compensation:

The land requisitioned in accordance with this Statute shall be compensated for at the market price through negotiation and agreement, the buildings, constructions, and/or irrigation facilities on the land requisitioned shall be compensated at the price of re-building; the crops which are not ready for harvest shall be compensated at the price of such crops as they are harvested at full ripeness. . . .

The market price referred to in the preceding paragraph means the prevailing price, in general transaction, of the land in the locality, used for the same purpose as the requisitioned land is used prior to requisition.¹⁶³

Furthermore, the original landowner is given a preferential right to purchase or lease the land for industrial use and is entitled to government assistance in doing so.¹⁶⁴ In addition, tenants as well as landowners are compensated for their land rights.¹⁶⁵

Requisition of land under this Statute is not a mere expropriation or regulatory taking. Rather, it is a policy by which the government functions almost like a market actor to facilitate distribution of land for industrial purposes. Of course, the government is playing a regulatory role in determining which areas should be designated as industrial areas and which areas should be preserved for agricultural use. However, this amounts to a type of "zoning" scheme that preserves the most fertile land for agriculture and locates industry near support infrastructures, such as ports and railroads. Because the government is required to purchase the land at market value prices and then lease or sell it to entrepreneurs who will presumably have to make efficient economic use of the land, the transactions should be subject to the pressures and disciplines of the market. Therefore, wasteful government takings which do not put the land to efficient use should be avoided.

IV. SEI CHAPTER IV: COORDINATION OF PUBLIC-OPERATED ENTERPRISES WITH PRIVATE ENTERPRISE

The key provisions of this Chapter deal with the joint development of projects between public enterprises and the private sector,

163. *SEI*, *supra* note 18, Art. 56.

164. *Id.*, Art. 57.

165. *Id.*, Art. 65.

the privatization of some publicly operated enterprises and the establishment of a national development fund.

Cooperation Between the Public and Private Sectors

Some development projects will involve participation from both the government and the private sector. For example, the government may encourage certain projects for policy reasons and yet it may be more efficient for the actual work to be done by the private sector. In such a case the government may provide "land, plant buildings, machinery, equipment and services of public-operated enterprises,"¹⁶⁶ while other requirements of the project such as investment capital, professional services and labor are supplied by the private sector. In some cases, such a project might take the form of a joint venture between the government and private investors. In other cases, the government might contract with private parties to provide various services to essentially government-operated projects. Perhaps in some cases, the government may contract out completely the development and/or operation of some project to private sector contractors.

The SEI provides for such cooperation between the public and private sectors. "For the purpose of coordinating economic development plans and accelerating economic growth, the government may make coordinating investments with private capital or participate in private enterprises for joint operations in establishing new enterprises or improving existing enterprises. . . ." ¹⁶⁷

Privatization of Publicly Operated Enterprises

Taiwan has several government-owned companies, many of which date back to the post-war days when government-operated industrial companies were used to help develop the country's basic industrial infrastructure. There are also several companies which, although ostensibly private, have significant government or KMT¹⁶⁸ investment resulting in quasi-government operated companies. The Statute provides that these may be transferred to private ownership by listing them on the securities market.¹⁶⁹

166. *Id.*, Art. 82.

167. *Id.*, Art. 82.

168. KMT refers to Kuomintang, the ruling party in the R.O.C.

169. *SEI, supra* note 18, Art. 83. See also, The Statute for Transfer of Public-Operated Enterprises to Private Ownership.

Establishment of a Development Fund

The Executive Yuan will establish a development fund using the proceeds derived from the privatization of public enterprises and other government funds and promulgate regulations for its use. This fund will be used:

- 1) For sole investments in important productive enterprises, as included in the economic development plans, which are beyond the capability of private investors or of no interest to private investors;
- 2) For joint investments in technology-intensive and important enterprises, as included in the economic development plans, which are promoted by private investors with insufficient capital;
- 3) For financing a technology-intensive and important enterprise, as included in the economic development plans, which requires the purchase of machinery and equipment for its own use but without sufficient capital; or,
- 4) In order to upgrade and improve the technology of a productive enterprise, the organization which manages the development fund may utilize the fund to finance the introduction of special technology, patent, or advanced design.¹⁷⁰

According to the above provisions, the development fund will help to foster cooperation between the public and private sectors by providing funds for public sector investment in private sectors enterprises that lack sufficient capital. The fund will also finance development of areas in which private sector investment is lacking.

The enterprises in which the development fund invests are to be operated as independent enterprises and are to be transferred to private ownership¹⁷¹ or sold to private investors once they become profitable.¹⁷²

In order to raise capital for the development fund, the government may issue development bonds listed on the securities market.¹⁷³

170. *SEI, supra* note 18, Art. 84.

171. According to *id.*, Art. 83.

172. *Id.*, Art. 85.

173. *Id.*, Art. 86. A proposal is to be made jointly by the agency in charge of the development and the Ministry of Finance and submitted to the Executive Yuan for approval. The proposal is to set out the relevant details regarding the bond issue including total amount for each issue, par value, interest rate and terms.

V. SEI CHAPTER V: SUPPLEMENTAL PROVISIONS

Enforcement rules under this Statute shall be issued by the Executive Yuan.¹⁷⁴ This Statute shall remain in force until December 31, 1990.¹⁷⁵

VI. CONCLUSIONS ON SEI

The preceding discussion should serve to introduce the reader to the policies behind the SEI and to make clear the important role this statute has played in encouraging Taiwan's phenomenal economic growth. It also should serve to dispel the myth that this economic growth has been due to some kind of "economic miracle." Taiwan's success is not "God-given" nor is it inexplicable or difficult to understand. It is quite simply, as stated in the introduction to this paper, a product of the people of Taiwan's hard work, encouraged by rational and productive economic policies implemented by the R.O.C. government through the legal system.

CHAPTER IV—THE STATUTE FOR UPGRADING INDUSTRIES (SUI)¹⁷⁶

The SUI consists of six chapters; General Provisions; Tax Benefits; Establishment and Utilization of the Development Fund; Technical Assistance; Establishment of Industrial Districts; and, Supplemental Provisions. As with the above discussion of the SEI, the following discussion of the SUI will follow the format of the six chapters but will give particular emphasis to the tax benefits in Chapter II. Where the provisions of the SUI are similar or related to those of the SEI, references will be made to the SEI to enable the reader to compare the relevant provisions. Limited references

The R.O.C. government traditionally has been quite conservative when it comes to issuing bonds and generally has avoided any deficit spending. Since few R.O.C. companies have issued bonds, the market for debt instruments is not well developed in the R.O.C. However, this may be changing. In 1989, Yuen Foong Yu Paper Manufacturing Company (YFY), one of Taiwan's largest diversified manufacturing companies, issued US\$100 million in 10-year, 25% coupon, convertible bonds. Also, the R.O.C. government recently announced a record budget of NT\$1.086 trillion (US\$43.39 billion). Under this budget, the government plans to issue NT\$235 billion (US\$9.4 billion) in government bonds. Furthermore, in order to finance the Six Year National Development Plan, additional government bond issues are likely to follow over the course of the next several years.

174. *SEI*, *supra* note 18, Art. 88. See also, Appendix 1 *infra* and notes 63 and 64 *supra*.

175. *SEI*, *supra* note 52.

176. *SUI*, *supra* note 52.

also will be made to the SUI's Implementing Regulations,¹⁷⁷ which provide more specific rules for the application of some of the SUI's provisions. These references to the Implementing Regulations will be set in from the left margin so as to differentiate them from the rest of the text.

I. SUI CHAPTER I: GENERAL PROVISIONS

The Purpose of the SUI and the Continued Application of Favorable Provisions of Other Relevant Laws

The purpose of the SUI is to upgrade industries and further improve economic development.¹⁷⁸ The SUI applies to all matters concerning industrial upgrading and, like the SEI, it also provides that, where the provisions of other applicable laws are more favorable than those of the SUI, the most favorable provisions apply.¹⁷⁹

Requirements to Qualify for Benefits Under the SUI

The SUI does not set out a list of "productive enterprises" such as those specified by the SEI.¹⁸⁰ In order for a company to qualify for the SUI's incentives and benefits, the only requirement is that the company must be organized under the Company Law as a company limited by shares.¹⁸¹

Although the SUI does contain certain provisions which provide benefits to foreign investors,¹⁸² the General Provisions of Chapter I make no mention of foreign enterprises. There is no requirement of FIA status as was the case under the SEI.¹⁸³ The SUI also makes no mention of the requirement that a foreign company be organized in a form equivalent to the company limited by shares as required by the SEI.¹⁸⁴ In fact, since the language of the SUI refers specifically to the Company Law (which, of course, must be

177. *Tzu Chin Ch'an Yeh Sheng Chi T'iao Li Shih Hsing Hsi Tse* (Implementing Regulations of the Statute for Upgrading Industries), promulgated April 24, 1991 (Executive Yuan) (R.O.C.) (Hereinafter cited as *SUI Regs.*) No English translation of the *SUI Regs.* is available. The author is responsible for the translations given in the text of this paper.

178. *SUI*, *supra* note 52, Art. 1.

179. *Id.*, Art. 2. (Compare *SEI* Art. 2.)

180. Compare with *SEI*, Art. 3.

181. *SUI*, *supra* note 52, Art. 3. See also note 58 *supra*.

182. These provisions will be discussed below.

183. Compare with *SEI*, Art. 3.

184. *Ibid.*

read to mean the R.O.C. Company Law) it follows that only R.O.C. companies are entitled to the benefits provided under the SUI. Considering that this statute was promulgated at a time when the further internationalization of the economy was an important element of R.O.C. economic policies, this lack of any reference to the application of the SUI's benefits to foreign enterprises seems somewhat strange.

A brief review of the legislative history¹⁸⁵ did not turn up any clues as to any policy behind this omission. However, it is probably safe to make the following few assumptions as to the policies involved. First, since Taiwan's economy and industrial enterprises are much more developed now as compared to 1960, when the SEI was promulgated, the SUI's policies foresee less need for foreign capital investment and technical assistance as compared to the SEI's policies.

Second, in those areas where foreign investment and/or technical assistance is desired, it would be more beneficial for Taiwan's economy to involve the foreign enterprises through alliances and/or joint ventures with local Taiwan companies, thus facilitating the transfer of advanced technology to local companies.¹⁸⁶

Third, since the purpose of the SUI is to upgrade Taiwan's industries, its benefits are to be made available to Taiwan's companies. Foreign investors who hope to enjoy the benefits of the SUI will have to either cooperate with local companies (e.g., strategic alliances), establish their own local companies (e.g., subsidiaries) or engage in some combination thereof (e.g., joint ventures).

Fourth, since foreign invested enterprises with FIA status are entitled to be treated the same as local enterprises,¹⁸⁷ a FIA enterprise which is organized as a company limited by shares is entitled to take advantage of the benefits and incentives provided under the SUI. Therefore, FIA status will continue to be attractive to foreign

185. This review was based on a survey of the Legislative Gazette (*Li Fa Yuan Kung Pao*).

186. For example, under the procurement rules for projects included in the Six Year National Development Plan (see note 13 and related text *supra*), R.O.C. companies are given preference. However, in some project areas local companies do not possess all the necessary advanced technology. Local companies which are in a position to bid for the projects will have to contract with or enter into joint ventures with foreign companies which possess the necessary technology and/or experience. Clearly, the R.O.C. government foresees this type of joint venture as a method of technology transfer for introducing advanced technologies into the hands of R.O.C. companies.

187. *SIFN*, *supra* note 27, Art. 20. See also, note 44 and related text *supra*.

investors even though the foreign exchange benefits of FIA status may be less important than they once were.¹⁸⁸

Authorities in Charge

At the central government level, the authority in charge under the SUI is the Industrial Development Bureau of the Ministry of Economic Affairs.¹⁸⁹

II. SUI CHAPTER II: TAX BENEFITS

Accelerated Depreciation of Fixed Assets

Instruments and equipment used exclusively for research and development, experimentation/testing and/or product quality control inspection, as well as machinery and equipment used for energy conservation or as alternative energy sources may be depreciated over an accelerated service life of two years.¹⁹⁰

For specifically designated industries, the service life for depreciation of machinery and equipment which is provided under the tax laws may be accelerated by one half. These industries are to be designated by the Executive Yuan based on the requirements for the adjustment of the industrial structure and the improvement of the scale of operations and the methods of production and reviewed every two years.¹⁹¹

“Instruments and equipment” and “for research and development and experimentation/testing” refer to newly purchased instruments and equipment used in research and development facilities or experimentation/testing facilities used to conduct research and development or experimentation/testing on one’s own behalf or on behalf of clients; it does not include instruments and equipment used in actual production.¹⁹²

188. The validity of these assumptions has been confirmed in correspondence between the author and Mr. Su Ming Ching, a Research Specialist with the Ministry of Economic Affairs Industrial Development and Investment Center.

189. *SUI*, *supra* note 52, Art. 4.

190. *Id.*, Art. 5. (Compare with *SEI*, Art. 6). The “semi-official” English translation, which was prepared by a major Taipei law firm reads: “. . . research and development purposes and/or inspection of pilot products. . . .” The text above offers a more literal translation of the Chinese characters used in the statute. The “semi-official” translation notes: “In case of any discrepancy between the English version and the Chinese text of this Law, the Chinese text shall govern.”

191. *SUI*, *supra* note 52, Art. 5.

192. *SUI Regs.*, *supra* note 177, Art. 7.

“Quality inspection instruments and equipment” refers to instruments and equipment used either in the production line or in experimental facilities to conduct quality control inspection on one’s own behalf or on behalf of clients.¹⁹³

Professional companies which specialize in research and development, software design development or experimentation/testing may utilize the accelerate depreciation provisions of SUI Art. 5.¹⁹⁴

“Energy saving instruments and equipment” refers to waste heat or pressure recovery equipment, boilers, generators, furnace systems and related equipment such as turbines, piping, and associated automated control systems.¹⁹⁵

“Machinery and equipment for alternative energy sources” refers to machinery for conversion of wind power, hydro-power, solar power, geothermal power and the like, and for production of energy from waste materials.¹⁹⁶

The applicable scope and procedures for the application of the SUI Art. 5, ¶ 2 is to be promulgated by the Executive Yuan after consultation with the Ministry of Finance and the industrial authorities concerned.¹⁹⁷

Investment Tax Credit

The SUI provides an investment tax credit of five to twenty percent of expenditures for the following purposes: (1) automation of production or production technology, (2) purchase of pollution control within five years of the effective date of this Statute; and, (3) research and development, training of professional personnel and the creation of internationally recognized brand(s) of products(s).

The tax credit may be taken against the Profit Seeking Enterprise Income Tax due for the current year, and where the amount of the available credit exceeds the amount of tax due in the current

193. *Id.*, Art. 7.

194. *Id.*, Art. 8.

195. *Id.*, Art. 9.

196. *Id.*, Art. 9.

197. *Id.*, Art. 10. Any further regulations which may have been issued under this provision were not available to the author during the research for this paper.

year, the balance of the credit may be carried forward for four years. However, except for the last year, the credits applied in each of the carry forward years may not exceed fifty percent of the tax due that year.¹⁹⁸

The scope and period of this tax credit is to be promulgated by the Executive Yuan after consultation with the Ministry of Finance, Ministry of Economic Affairs, and industrial authorities.¹⁹⁹

It should be noted here that the tax holiday available under the SEI²⁰⁰ is not available under the SUI. Obviously, since the tax holiday is no longer available, the deferral²⁰¹ of the tax holiday is also no longer available. This reduction of the most favorable incentives fits the usual pattern. In the early stages when rapid economic growth is necessary, extremely favorable incentives are offered. Once the country's economy is quite well-developed, such extreme incentives are no longer necessary and more limited incentives are used to encourage continued economic growth and further industrial development.

Tax Credit for Investment in Less Developed Areas of the Country

In order to encourage investment in less well-developed areas and areas with limited natural resources, an investment tax credit of up to twenty percent is provided for investment in such areas. A four-year carry forward similar to that discussed above is also provided for.²⁰²

To qualify for this tax credit, the enterprise must invest a specified minimum amount of capital or employ a specified minimum number of people. These minimums are to be specified by the Executive Yuan.²⁰³

198. *SUI*, *supra* note 52, Art. 6 (Compare SEI Art. 10).

199. *SUI Regs.*, *supra* note 177, Art. 13. According to the local Chinese press (*Shih Chie Jih Pao*) (World Journal 5 November 1991), the regulations originally required the equipment to be purchased during 1991. However, due to a poor response from industry, the Ministry of Finance and the Ministry of Economic Affairs have extended the qualifying period through 1992.

200. See *SEI*, *supra* note 18, Art. 6 ¶ 1.

201. *Id.*, Art. 7.

202. *SUI*, *supra* note 52, Art. 7.

203. *Id.*, Art. 7. The minimum required investment or number of employees is not specified in the *SUI Regs.*

It is interesting to note that this is a completely new provision which had no precedent in the SEI. Until now, Taiwan's economic development has been highly concentrated in a few locations. Most office based businesses are located in Taipei, the capital city, which is at the north end of the island. Many heavy industries have been located in Kaohsiung, a major port city at the south end of the island. Much of the central part of the island is mountainous and not easily accessible.

This over-concentration of businesses and people in a few small locations has resulted in Taiwan's infamous traffic, pollution and overcrowding. The development of other areas of the island has now become a high priority for the R.O.C. government. The Six Year National Development Plan²⁰⁴ includes projects to improve the transportation infrastructure by extension of existing highways, construction of four new freeways and introduction of a high-speed railway system. The Plan also includes projects for improvement of housing, medical, cultural and educational facilities in less developed areas, and the scale of some of these projects are such that they actually amount to building new cities.

Tax Credit for Investment in Shares of High Technology Enterprises and Venture Capital Enterprises

Investors who subscribe to or underwrite the original issue of shares for the establishment or expansion of a government designated "important technology-based enterprise" or "important invested enterprise" and who hold the shares for at least two years are entitled to a tax credit of up to twenty percent of the amount paid for the shares. There is a carry forward provision similar to that discussed above.²⁰⁵

This credit also applies to investment in a venture capital enterprise. In the case of a venture capital enterprise, the amount of the carry forward credit allowed for each year is determined according to a ratio between the amount of the venture capital enterprise's investment in technology-based enterprises and the amount of the venture capital enterprise's paid-in capital.²⁰⁶

The applicable scope of the "important technology-based enterprises" and the "important invested enterprises" is to be promulgated by the Executive Yuan after

204. See note 13 and related text *supra*.

205. *SUI*, *supra* note 52, Art. 8 (Compare with *SEI*, Art. 20-1).

206. *Id.*,

consultation with the Ministry of Finance and the industrial authorities.²⁰⁷

The applicable scope of "venture capital enterprises" is to be promulgated by the Executive Yuan after consultation with the Ministry of Economic Affairs.²⁰⁸

The Implementing Regulations provide further detailed requirements to qualify for this tax credit which will not be discussed here.²⁰⁹

Tax Exemption for Income Derived From Patent Rights

Where an R.O.C. national earns royalties from the licensing of, or income from the sale of, either a patent right or a copyright in computer software, that income is exempt from income tax.²¹⁰

Reserve Against Loss From Overseas Investment

Where, in response to a government policy and with the approval of the relevant authorities, a company makes an investment overseas, an amount up to twenty percent of the invested amount may be set aside as a reserve against potential losses from the outbound investment.

In order to qualify, the R.O.C. investor must hold at least twenty percent of the equity of the overseas enterprise. And if no actual loss is incurred within three years after the reserve is set aside, the reserved amount will be treated as income in the third year.²¹¹

The outbound investment must be approved²¹² by the Investment Commission (IC)²¹³ according to the Regulations Governing

207. *SUI Regs.*, *supra* note 177, Art. 15.

208. *Id.*, Art. 16.

209. *Id.*, Arts. 17 and 18.

210. *SUI*, *supra* note 52, Art. 9. (Compare with *SEI*, Art. 36). It is interesting to note that the *SEI*'s precedent for this provision referred only to patent rights and did not mention copyrights in computer software. It also should be pointed out that the English translation of this provision reads: "the patent right or the copyright in computer software." This might easily be read to mean that the only patent rights referred to are those in computer software. However, the Chinese text clearly refers to patent rights in general and to copyrights in computer software only.

211. *SUI*, *supra* note 52, Art. 10.

212. *SUI Regs.*, *supra* note 177, Art. 21.

213. See note 30 and related text *supra*.

the Screening and Handling of Outward Investment and Outward Technical Cooperation Projects.²¹⁴

Reduction of Withholding Rate for Non-Resident Investors

Income tax on dividends or profits distributed to a foreign investor by an enterprise with FIA status will be withheld at a reduced rate of twenty percent.²¹⁵

This withholding provision also applies to a foreign investor who has resided in the R.O.C. for more than 183 days²¹⁶ of a tax year to act as a manager, director or other such officer of the FIA status enterprise.

Foreign Investor's Salary not Treated as R.O.C. Source Income

Remuneration paid outside of Taiwan to foreign nationals who reside in Taiwan for less than 183 days in a tax year for the purposes of establishing operations of an enterprise with FIA status are specifically deemed non-R.O.C. source income.²¹⁷ This income is thus protected from R.O.C. tax liability.²¹⁸

Reduction of Tax Liabilities Incident to Mergers

In the course of a corporate merger or consolidation, various tax liabilities will be incurred. For example, various documents will create stamp tax liabilities and transfers of land will create land value increment tax and deed tax liabilities. These tax burdens are eliminated and/or reduced for mergers which have been specifically approved by the Ministry of Economic Affairs.²¹⁹

Reduction of Tax Liabilities Incident to Relocation of Production Facilities

If, for any of the following reasons, an enterprise relocates its factory to a designated industrial district and then sells or transfers its original factory site, the land value increment tax will be assessed

214. *Tui Wai T'ou Tse Chi Shu He Tsuo Shen He Ch'u Li Pan Fa* (Regulations Governing the Screening and Handling of Outward Investment and Outward Technical Cooperation Projects) promulgated June 12, 1964, last amended January 21, 1987 (R.O.C.).

215. *SUI*, *supra* note 52, Art. 11. (Compare with *SEI*, Art. 16).

216. See note 100 *supra*.

217. *SEI*, *supra* note 18, Art. 18.

218. *SUI*, *supra* note 52, Art. 12. (Compare with *SEI*, Art. 18).

219. *Id.*, Art. 13. (Compare with *SEI*, Art. 38).

at the lowest applicable tax rate. These reasons are: (1) the original site does not conform to new zoning regulations; (2) the original site does not meet pollution control or other environmental needs approved by the authority in charge, or, (3) the government initiated the move.²²⁰

Increase in Amount of Permitted Retained Earnings

A company may retain earnings up to an amount equal to its paid-in capital. An "important productive enterprise" designated by the government may retain earnings up to twice the amount of its paid-in capital.²²¹

The applicable scope of the "important productive enterprises" is to be promulgated by the Executive Yuan after consultation with the Ministry of Finance and the industrial authorities.²²²

Tax Incentive for Shareholders

Where a company issues new shares to its shareholders representing the re-investment of undistributed earnings for any of the reasons listed below, the value of the newly issued shares will not be included in the shareholder's taxable income for the current year. These reasons are:

1. To add or replace machinery, equipment or transportation facilities used in production of goods, provision of services, research and development, quality control inspection or energy conservation; or to improve industrial safety and hygiene standards;
2. To repay a debt or account payable incurred for any of the reasons stated in the subparagraph above; or,
3. To re-invest in an important enterprise according to Article 8 of this Statute.²²³

Only new machinery, equipment, or transportation facilities may qualify.

Debt refers to borrowing from financial institutions, corporate bonds, long-term letters of credit, docu-

220. *SUI*, *supra* note 52, Art. 14. (Compare with *SEI*, Art. 39).

221. *Id.*, Art. 15. (Compare with *SEI*, Art. 41).

222. *SUI Regs.*, *supra* note 177, article 29.

223. *SUI*, *supra* note 53, Art. 16. (Compare with *SEI*, Art. 13). There are detailed regulations regarding the corporate procedures that must be followed to qualify under these provisions. The regulations require approval at a shareholders meeting and extensive paperwork and documentation of all the details of the transaction. See *SUI Regs.*, *supra* note 177, Arts. 31 through 37.

ments against acceptance, delivery against payment and commercial paper.

Important enterprise refers to "important invested enterprises" as specified under Article 8 of this Statute and Article 15 of the Implementing Regulations.²²⁴

Incentive for Employee Investment

The above provisions also apply to employees who receive shares of their employer by re-investing their bonuses in a capital increase.²²⁵

Incentive for Investors in Venture Capital Enterprises

Shareholders of venture capital enterprises are also entitled to take advantage of the above provision.²²⁶

Business not Taxed on Appreciation of Assets

Where a profit seeking enterprise revalues its assets according to the Income Tax Law, the appreciated value will not be treated as taxable income.²²⁷

Issue of Shares Above Par-Value Sheltered from Income Tax

Where a company issues shares above par value in accordance with the Company Law and the premium is set aside as a reserve, the amount of the premium is excluded from the current year's taxable income.²²⁸

Tax Exemption for Corporate Investment in Venture Capital Enterprises

Where a company invests in a venture capital enterprise, eighty percent of the income derived from that investment is excluded from the company's taxable income for the current year.²²⁹

224. *SUI Regs.*, *supra* note 183, article 30.

225. *SUI*, *supra* note 52, Art. 17. (Compare with *SEI*, Art. 13).

226. *Id.*, Art. 17. (Compare with *SEI*, Art. 13). See also, *SUI Regs.*, *supra* note 177, Art. 35.

227. *SUI*, *supra* note 52, Art. 18. (Compare with *SEI*, Art. 42).

228. *SUI*, *supra* note 52, Art. 19. (Compare with *SEI*, Art. 25).

229. *SUI*, *supra* note 52, Art. 20. (Compare with *SEI*, Art. 16-3).

III. SUI CHAPTER III: ESTABLISHMENT AND UTILIZATION OF DEVELOPMENT FUND

The Executive Yuan is to establish and operate a development fund using appropriations from the National Treasury for the following purposes:

- 1) To invest and participate in important enterprises or projects which relate to the upgrading of industries or the improvement of the industrial structure which is beyond the private sector's capabilities or financial means.
- 2) To provide financing for important enterprises or projects which relate to the upgrading of industries or the improvement of the industrial structure but have insufficient capital.
- 3) To provide financing to assist sound industrial development according to government policies.
- 4) To assist the development of small and medium size enterprises through the use of an appropriate percentage of the development fund.
- 5) To coordinate the efforts of the relevant authorities to acquire advanced technologies from abroad to strengthen research and development, training of personnel, pollution control and improvement of the industrial structure, and to promote sound economic development.
- 6) Other cases as specifically approved by the Executive Yuan.²³⁰

IV. SUI CHAPTER IV: TECHNICAL ASSISTANCE

Chapter IV consists of only one article and the Implementing Regulations do not contain any provisions relating to this Article.

"In order to encourage the acquisition and transfer of technologies the government shall assist in the establishment of technology transfer unit(s) [organization(s)] and provide and coordinate tech-

230. *SUI*, *supra* note 52, Art. 21. (Compare with *SEI*, Art. 84). It should be noted here that the *SUI Regs.* do not contain any provisions relating to the Development Fund. Any regulations or guidelines that may have been issued subsequently by the Executive Yuan were not available to the author at the time of this writing.

nical assistance. Regulations governing this provision shall be established by the Executive yuan."²³¹

The nature and scope of the technology transfer organization(s) to be established under this provision are not yet clearly determined. For example, a technology transfer center might be government operated, privately operated or operated jointly with both government and private sector participation. The next question might be whether the technology transfer unit should be set up as a corporation and operated for profit or established as a non-profit foundation. It might be independent or it might be associated with another institution such as a university or a research institute. The establishment of a technology transfer center raises many interesting issues and possibilities. During the next several years, Taiwan will certainly offer many exciting opportunities in this field for interested technical, business and legal professionals.²³²

V. SUI CHAPTER V: ESTABLISHMENT OF INDUSTRIAL DISTRICTS

This Chapter and Articles 23 through 42 of the Implementing Regulations deal with issues relating to regional industrial planning, zoning, expropriation of privately owned land according to government development policies and others. For purposes of this paper, only a few of the most important features of this Chapter will be pointed out here.²³³

Expropriation of Private Land

Where land is to be expropriated for use as part of an industrial district, the authorities in charge are to negotiate with the landowner to reach an agreed-upon compensation. The agreed-upon compensation should be the fair market value in general transactions. Other compensation for buildings or improvements on the

231. *SUI*, *supra* note 52, Art. 22. The translation in the above text differs slightly from the "semi-official" translation. The above text is a more literal translation of the Chinese characters used in the actual Chinese text.

232. At the time of this writing, the author is assisting Professor Paul C.B. Liu of the University of Washington in a research project in this field. The questions raised in the above text are the issues which we are now researching for a feasibility study for the establishment of a technology transfer center in Taiwan.

233. Detailed consideration of these topics and related issues of R.O.C. property law will not be discussed in detail here.

expropriated land should be paid based on the cost of rebuilding such buildings or improvement.²³⁴

If the parties cannot reach a negotiated price, the case is referred to the Committee for Assessment of Land Value and the Committee for Assessment of Standard Land Value.²³⁵

Use of Public Land

Where public land is to be used for the development of an industrial district, local authorities who administer the land will be compensated in the same manner as used for privately owned land. However, if all the land in an industrial district is publicly owned, then the price will be determined according to the standards for disposition of public property.²³⁶

Protection of Tenants

Tenants who lease publicly or privately-owned farmland will be compensated upon the termination of their lease. The price will be one third of the land price, less the land value increment tax, plus the value of unharvested crops or improvements made to the land.²³⁷

Use of Land and Buildings in Industrial Districts

An entrepreneur who rents or purchases land or factory building(s) in an industrial district must use the land or building(s) in accordance with the approved plan.²³⁸

If the land or building(s) are used in a manner which violates the above provision, the authorities in charge may:

- 1) Compel the entrepreneur to sell the land back to the authorities at the original selling price or sell back factory building(s) at the original selling price less depreciation, or
- 2) terminate the lease and repossess the leased premises.

234. *SUI*, *supra* note 52, Art. 25.

235. *Id.*, Art. 25.

236. *Id.*, Art. 26.

237. *Id.*, Art. 26.

238. *Id.*, Art. 36.

If the entrepreneur has made any improvements to the premises, they will be compensated at the depreciated value of the improvements made.²³⁹

Transfer of Land and Building in Industrial Districts

Once land in an industrial district is leased or sold to an entrepreneur, it may not be transferred unless the planned use has been completed and the factory certificate has been registered.²⁴⁰

Land or factory buildings in an industrial district may not be transferred except to another entrepreneur with the approval of the authorities. The approval letter from the authorities is required in order to register the transfer of title to the land.²⁴¹

Industrial District Maintenance Fee

The authority in charge of an industrial district shall collect a maintenance fee from all users in the industrial district at a rate to be approved by the Executive Yuan.

The maintenance fee is to be used to cover the costs of operation and administration of the industrial district, including: personnel and administrative expenses, public security, maintenance of public facilities, landscape facilities, and environmental and sanitation facilities.

In the event that any user of an industrial district does not pay the required fee, the authorities will refer the case to the courts.²⁴²

VI. SUI CHAPTER VI: SUPPLEMENTAL PROVISIONS

The enforcement rules²⁴³ of this Statute shall be promulgated by the Executive Yuan.²⁴⁴

This Statute entered into force on January 1, 1991 and shall remain in force through June 30, 1998.²⁴⁵

VII. CONCLUSIONS ON SUI

The SUI is basically a continuation of the policies previously addressed in the SEI. Since these policies have been proven suc-

239. *Id.*, Art. 38.

240. *Id.*, Art. 37.

241. *Id.*, Art. 37.

242. *Id.*, Art. 40.

243. See *SUI Regs.*, *supra* note 177.

244. *SUI*, *supra* note 52, Art. 43

245. *Id.*, Art. 44.

cessful by Taiwan's phenomenal economic growth, there would seem to be little reason to make any major changes. However, Taiwan's economy has now entered a new, more advanced stage of development quite different from that which existed at the time that the SEI was first promulgated. Taiwan's modern economy presents new challenges that require new policies. These new policies account for some important differences between the SEI and the SUI.

CHAPTER V—GENERAL CONCLUSIONS AND IMPLICATIONS FOR UNITED STATES ECONOMIC POLICIES

Perhaps the most important lesson which should be taken from a study of Taiwan's economic success is that government economic policies, as implemented through the legal system, can play an important, productive and successful role in encouraging economic growth and development.

If we compare Taiwan's current economic condition to that of the United States, we can demonstrate that government policies which encourage the people's entrepreneurial talents and allow them to enjoy the fruits of their efforts will result in economic growth (Taiwan), while policies which penalize the productive sectors of society and do nothing to encourage productivity can result in economic stagnation and decline (United States).

Government economic policies may be implemented in radically different ways. For example, the government may take a hands-off, laissez-faire attitude towards the economy and allow Adam Smith's "invisible hand" of capitalism to work through the free market.²⁴⁶ The limited role of government is merely to create conditions that are conducive to economic growth (i.e., peace and stability) and then leave the rest to the private sector. Few investment incentives are necessary in such an economy because the private sector operates very freely with minimal governmental interference, and because limited government implies limited taxation.²⁴⁷

On the other hand, the government may take a more active role and implement economic policies by directly influencing the

246. For example, this has been the predominant policy of the British authorities in Hong Kong for 150 years and Hong Kong's economy has flourished.

247. This was once considered the standard model for the American economy; however, that is no longer the case.

private sector through the exercise of its administrative authority over industry. Extensive, far-reaching and pervasive "administrative guidance," where successful, produces a close, cooperative partnership between government and industry, which work together for the collective economic good of the nation.²⁴⁸

Taiwan's experience has been somewhere in between these two models. Clearly the R.O.C. is not a laissez-faire regime of limited government. There is government involvement in the economy and cooperation between the public and private sectors. However, rather than merely directing the economy through cooperation between the public and private sectors, the R.O.C. government's role has been to encourage the private sector through economic incentives. Therefore, as pointed out in the introduction to this paper, Taiwan's success had been built by the success of many small and medium size private enterprises and not by large industrial and financial conglomerates who work closely with government bureaucrats. The role of the R.O.C. government has been first to create conditions that are conducive to economic growth (i.e., peace and stability) and then to offer incentives that actively encourage private entrepreneurs to productively take advantage of those conditions.

In comparison, the role of the U.S. government today in the nation's economic sector is neither productive nor successful. Our governmental regulation of business and irrational tax system have been described by at least one writer as "the invisible foot".²⁴⁹ And our politically motivated redistribution of wealth²⁵⁰ through our tax system and our system of "entitlements" penalizes the productive elements of our society and provides no incentives to improve productivity.

From the traditional (conservative) American perspective on the role of government in the national economy, one easily might

248. This is the so-called "Japan, Inc." or "corporate state" model. A third model, the centrally-planned socialist economy (e.g., that of the former Soviet Union or mainland China), has been sufficiently discredited by recent history that it will not be discussed in this paper.

249. Former economics professor, now Congressman, Dick Armey is credited with creating the term "the invisible foot" in correspondence with Professor Milton Friedman. The term describes the adverse effects of excess government interference in the economy, the opposite of Adam Smith's more economically positive "invisible hand".

250. You cannot redistribute wealth that is not being created. The less fortunate members of society might be better served by a government which recognizes that a prerequisite for any program to help the poor is a sound national economy that produces wealth.

conclude that the R.O.C. government is involved in sectors of the economy which we would prefer to leave to the private sector.²⁵¹ However, the actual state of affairs in the United States is such that the traditional view is no longer a reality. We now have a federal bureaucracy that reaches into every area of our economy and that burdens our productive sectors with incomprehensible regulations and tax laws.

Speaking pragmatically rather than ideologically, and leaving aside for the moment the many arguments for reducing or eliminating this bureaucracy, we would appear to be stuck with this "big-government" and are not likely to be able to reduce it to its more traditional, conservative role. In fact, the current trend is not toward limiting government but rather toward an ever-expanding government bureaucracy that is becoming ever more involved in our economy.

Furthermore, it is frequently argued these days that even if the traditional role of government is a more limited one, in the modern, global marketplace we need a "national industrial and/or economic policy" to compete with countries such as Japan and Taiwan, which have such policies.

While we may choose not to go so far as creating a national development fund based on Taiwan's model²⁵² or to establish our own version of MITI,²⁵³ we should certainly be able to learn from successful models and incorporate those elements that are useful in our economic context. As mentioned in the introduction to this paper, Taiwan's economy of small and medium size enterprises generally bears more resemblance to the individual, entrepreneurial American model rather than to the more group-oriented Japanese model. It seems logical that certain successful elements of Taiwan's experience could be put into practice in the United States.

Reliable tax incentives for savings and productive investment, such as those provided under the SEI and the SUI, produce long-term economic growth. Long-term economic growth creates a strong, prosperous and competitive nation. Only a strong, prosperous and competitive nation can provide a rising standard of living for its citizens. A society that hopes to share its wealth with its less

251. For example, this conclusion easily might be reached concerning areas such as the Executive Yuan Development Fund and the provisions for governmental technical assistance.

252. Considering our federal budget deficit, we clearly do not have the necessary funds anyway.

253. MITI is Japan's Ministry of International Trade and Industry.

fortunate members must first create that wealth, and the efficient way to do it is to enable the people themselves to create that wealth.

It has been argued that the dynamic economies of successful East Asian countries prosper at the expense of their people. The argument is that the people's well-being is subjugated to national economic goals. The argument continues: if these countries provided for their people's welfare through entitlement programs such as those in the United States, not only would their citizens' standards of living²⁵⁴ be raised, but also their international competitiveness would be lowered, i.e., brought closer to that of the United States.

There are many examples that may be taken from the countries of East Asia to refute such an argument. For example, in Hong Kong, which probably has the most purely capitalist, laissez-faire economy in the world,²⁵⁵ the vast majority of the population lives in government subsidized housing.²⁵⁶ Medical care also is subsidized in Hong Kong.²⁵⁷ Taiwan, for example, has long required employers to provide worker's insurance²⁵⁸ and recently has passed legislation to institute universal health insurance for all citizens beginning in 1994.

Notwithstanding the importance of these "social welfare" programs, the most important role of the government in these dynamic East Asian economies has been to encourage overall economic growth, not to redistribute wealth or equalize social conditions.

254. While it is true that the United States still has the world's highest standard of living, it has already begun to decline and those of East Asian countries such as Taiwan are rising rapidly.

255. Hong Kong's economy has been described as "Milton Friedman's dream comes true." The tax system is based on a flat rate (approximately 15% for personal income tax and 17.5% for corporate income tax) and the threshold at which tax liability is incurred is high enough such that much of the working population pays little or no income tax.

256. Government subsidies for housing began as an effort to provide housing for the huge influx of refugees from China during the cultural revolution.

257. Apparently the system is quite a bit more successful in Hong Kong than it is in Britain.

258. Under Taiwan's compulsory system of worker's insurance (Lao Pao), employees contribute a certain percentage of the cost of insurance through payroll deductions and the employer contributes the rest. See *Lao Kung Pao Hsien Fa* (The Labor Insurance Law), promulgated July 21, 1981, last amended February 3, 1988 (R.O.C.).

The success of economic incentives and tax benefits such as those provided under the SEI and the SUI has been demonstrated and proven in actual practice by the “economic miracle” Taiwan has achieved, and by which all of Taiwan’s citizens have benefitted. The United States may wish to study Taiwan’s success and perhaps implement some of its elements to improve its own economic condition.

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僑外投資負面表列禁止及限制僑外人投資業別項目(Ch'aio Wai T'ou Tse Fu Mian Piao Lie-Chin Chih Chi Hsien Chih Ch'aio Wai Jen T'ou Tse Yeh Pie Hsiang Mu), Negative List for Investment by Overseas Chinese and Foreign Nationals, promulgated under SIFN, Art.5, last amended August 1991, Executive Yuan, R.O.C..

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APPENDIX 1

PARTIAL LIST OF REGULATIONS ISSUED UNDER THE STATUTE FOR ENCOURAGEMENT OF INVESTMENT*

生產事業獎勵類目及標準 (Sheng Ch'an Shih Yeh Chiang Li Lei Mu Chi Piao Chun), Categories and Criteria of Productive Enterprises Eligible for Encouragement, promulgated under SEI, Art.3, last amended November 26, 1986, expired May 3, 1991, Executive Yuan, R.O.C..

行政院核定修正生產事業獎勵類目及標準 (Hsing Cheng Yuan He Ting Hsiao Cheng Sheng Ch'an Shih Yeh Chiang Li Lei Mu Chi Piao Chun), Revised Categories and Criteria of Productive Enterprises Eligible for Encouragement Approved by the Executive Yuan, promulgated under SEI, Art.3, November 3, 1990, Executive Yuan, R.O.C..

重要生產事業特別獎勵適用範圍及標準 (Chung Yao Sheng Ch'an Shih Yeh Te Pie Chiang Li Shih Yung Fan Wei Chi Piao Chun), Categories and Criteria of Important Productive Enterprises Eligible for Special Encouragement, promulgated under SEI, Art.15, last amended October 27, 1981, expired May 3, 1991, Executive Yuan, R.O.C..

工礦業或事業創立或擴充獎勵標準 (Kung K'uang Yeh Huo Shih Yeh Ch'uang Li Huo K'uo Ch'ung Chiang Li Piao Chun), Criteria for Encouragement of Establishment or Expansion of Mining or Industrial Enterprises or [other] Enterprises, promulgated under SEI, Art.20, March 16, 1987, last amended November 30, 1987, expired May 3, 1991, Executive Yuan, R.O.C..

生產事業研究發展費用適用投資抵減辦法 (Sheng Ch'an Shih Yeh Yen Chiu Fa Chan Fei Yung Shih Yung T'ou Tse Ti Chian Pan Fa), Measures For Application of Tax Credit for Research and Development Expenses for Productive Industries, promulgated under SEI, Art.34, September 16, 1985, expired April 24, 1991, Executive Yuan, R.O.C..

*This list contains only those items that are available in the University of Washington law library and some which the author has obtained from sources in Taiwan. It is not a complete list of all the Regulations, Guidelines, Procedures and other documents promulgated under the SEI.

生產事業輸入機器設備分期繳納及免徵進口稅捐實施辦法(Sheng Ch'an Shih Yeh Shu Ju Chi Ch'i She Pei Fen Ch'i Chiao Na Chi Mien Cheng Chin K'ou Shui Chuen Shih Shih Pan Fa), Enforcement Rules Governing the Payment in Installments of and Exemption from Duties and Dues Leviable on Machinery and Equipment Imported by Productive Enterprises, promulgated under SEI, Art.21 ¶4, November 5, 1971, last amended November 7, 1981, Ministry of Finance, R.O.C..

獎勵對外投資事業適用範圍及輔導管理辦法(Chiang Li Tui Wai T'ou Tse Shih Yeh Shih Yung Fan Wei Chi Fu Tao Kuan Li Pan Fa), Applicable Scope and Rules for Encouragement of Outbound Investment Enterprises, promulgated under SEI, Art.8, July 12, 1987, Executive Yuan, R.O.C..

策略性工業之適用範圍(Ts'e Lue Hsing Kung Yeh Chih Shih Yung Fan Wei), Applicable Scope of the Strategic Industries, promulgated under SEI, Art.41 ¶2, December 23, 1986, expired April 24, 1991, Executive Yuan, R.O.C..

民營生產事業購置國產產業機械防治汙染設備適用投資抵減辦法(Min Ying Sheng Ch'an Shih Yeh Kou Chih Kuo Ch'an Ch'an Yeh Chi Chie Fang Chih Wu Jan She Pei Shih Yung T'ou Tse Ti Chien Pan Fa), Measures Governing the Investment Tax Credit for Purchase by Private Productive Enterprises of Domestically Produced Industrial Machinery and Pollution Control Equipment, promulgated under SEI, Art. 10, June 29, 1988, expired May 3, 1991, R.O.C..

APPENDIX 2

OTHER CLOSELY RELATED REGULATIONS AND GUIDELINES*

僑外投資負面表列-禁止及限制僑外人投資業別項目 (Ch'ao Wai T'ou Tse Fu Mian Piao Lie-Chin Chih Chi Hsien Chih Ch'ao Wai Jen T'ou Tse Yeh Pie Hsiang Mu), Negative List for Investment by Overseas Chinese and Foreign Nationals, promulgated under SIFN, Art.5, last amended August 1991, Executive Yuan, R.O.C..

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對外投資及技術合作審核處理辦法 (Tui Wai T'ou Tse Chi Chi Shu He Tso Shen He Chu Li Pan Fa), Regulations Governing the Screening and Handling of Outward Investment and Outward Technical Cooperation Projects, promulgated June 12, 1964, last amended January 21, 1987, R.O.C..

投資機會 (T'ou Tse Chi Hui), Investment Opportunities, Ministry of Economic Affairs, Industrial Development and Investment Center, July 1990, R.O.C..

*See note following Appendix 1.

APPENDIX 3

LIST OF NEW REGULATIONS ISSUED UNDER
THE STATUTE FOR UPGRADING INDUSTRIES*

股份有限公司研究與發展人才培訓及建立國際品牌形象支出適用投資抵減辦法 (Ku Fen You Hsien Kung Se Yan Chiu Yu Fa Chan Jen Ts'ai P'ei Hsun Chi Chien Li Kuo Chi P'in P'ai Hsing Hsiang Chih Chu Shih Yung T'ou Tse Ti Chien Pan Fa), Procedure for Application of Tax Credit for Expenditures for Research and Development, Personnel Training and Establishment of International Brands by a Company Limited by Shares, promulgated June 28, 1991 under SUI, Art. 6-3, R.O.C..

主導性新產品開發輔導辦法 (Chu Tao Hsing Hsin Chan P'in Kai Fa Fu Tao Pan Fa), Procedures for Encouragement of Development of Leading New Products, promulgated June 5, 1991, R.O.C..

民營製造及技術服務業購置自動化生產設備或技術、防治汙染設備或技術適用投資抵減辦法 (Min Ying Chih Tsao Chi Chi Shu Fu Wu Yeh Kou Chih Tse Tung Hua Sheng Chan She Pei Huo Chi Shu, Fang Chih Wu Jan She Pei Huo Chi Shu Shih Yung T'ou Tse Ti Chien Pan Fa), Procedure for Application of Tax Credit for Purchase of Automated Production Equipment or Technology, Pollution Control Equipment or Technology by Manufacturing or Technical Services Enterprises, promulgated April 15, 1991 under SUI, Art. 6-3, R.O.C..

創業投資事業之適用範圍標準 (Chuang Yeh T'ou Tse Shih Yeh Chih Shih Yung Fan Wei Piao Chun), Applicable Scope and Standards for Use by Venture Capital Enterprises, promulgated August 24, 1992 under SUI, Art. 8-3, R.O.C..

民營農業購置自動化生產設備或技術及防治汙染設備或技術適用投資抵減辦法 (Min Ying Nung Yeh Kou Chih Tzu Tung Hua Shen Ch'an She Pei Huo Chi Shu Chi Fang Chih Wu Jan She Pei Huo Chi Shu Shih Yung T'ou Tse Ti Chien Pan Fa), Procedure for Application of Tax Credit for Purchase of Automated Production Equipment or Technology and Pollution Control Equipment or Technology by Private Agricultural Enterprises, promulgated June 7, 1992, R.O.C..

* List updated as of February 20, 1993.

股份有限公司投資於資源貧瘠或發展遲緩地區適用投資抵減辦法
(Ku Fen You Hsien Kung Se T'ou Tse Yu Tse Yuan Pin Chi Huo Fa Chan Chih
Huan Ti Chu Shih Yung T'ou Tse Ti Chien Pan Fa), Procedure for
Application of Tax Credit for Investment in Resource Poor or
Underdeveloped Areas By a Company Limited by Shares, promulgated July
24, 1992, R.O.C..

重要科技事業適用範圍標準, (Chung Yao K'e Chi Shih Yeh Shih Yung
Fan Wei Piao Chun), Applicable Scope and Standards for Use by Important
Technological Enterprises, promulgated February 10, 1993, R.O.C..

APPENDIX 4
COMPARISON CHART OF IMPORTANT
PROVISIONS OF THE SEI AND SUI

<u>SEI</u>	<u>SUI</u>
<u>QUALIFICATION FOR BENEFITS</u>	
CLBS ²⁵⁹	CLBS
FIA ²⁶⁰ status (if foreign)	no mention of foreign cos.
"productive enterprise"	no specified type of co.
<u>TAX HOLIDAY</u>	
4 or 5 year tax holiday (potential 4 year deferral)	no tax holiday
<u>ACCELERATED DEPRECIATION</u>	
new enterprise:	accelerated by 2 yrs. for
accelerated by 1/3	most equip. or 1/2 of service
renovation of equipment:	life for most favored
accelerated by 50%	
<u>INVESTMENT TAX CREDITS</u>	
5-20% for production equip.	5-20% for automation, pollution control, r&d & personnel training
up to 30% of shares in important tech. ent.	up to 20% for investing in underdeveloped areas
up to 20% for shares in VC ²⁶¹ ent.	up to 20% of shares in high- tech & VC firms after held for 2 yrs.
15% tax reduction if co. taken public	not mentioned

259. company limited by shares

260. foreign investment approval

261. venture capital

EXEMPTIONS FROM INCOME TAX

newly issued shares issued upon re-investment of earnings	same
80% of income from investment in VC firm by CLBS	same
patent income	patent and/or software copyright
certain savings accounts	not mentioned
reserve from issue of shares above par	same

RETAINED EARNINGS

CLBS 50% p.i.c. ²⁶²	CLBS 100% p.i.c.
productive ent. 100% p.i.c.	important productive ent. 100% p.i.c.

RESERVE AGAINST FOREIGN INVESTMENT LOSSES

1% forex reserve for export	w/ IC ²⁶³ approval up to 20% of overseas investment
7% forex loan debt	

REDUCTION OF FOREIGN INVESTOR'S WITHHOLDING TAX LIABILITY

w/ FIA 20%	same
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262. paid in capital

263. investment commission

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