

Cathay Financial Holdings Tax Governance Report 2018

• Tax Governance Policy

Cathay Financial Holdings (“Cathay FHC”) recognizes the need to adhere to global trends in the strengthening of its tax governance. The establishment of “Cathay Financial Holdings Tax Governance Policy” reinforces effective control of tax risks, helps Cathay FHC in its implementation of corporate sustainability, enhances shareholder value, and fulfills its corporate social responsibility. The Board of Directors has the final decision-making authority to ensure that sound tax risk management mechanisms are implemented in Cathay FHC. The Tax Management Unit periodically submits reports to the Risk Management Division. The Risk Management Division submits annual tax management reports to the Board of Directors in order to ensure the tax management mechanism's effective operation and properly implementation of tax governance. Cathay FHC's tax governance is based on the principles of good faith and integrity and is as follows:

- I. Cathay FHC shall calculate all tax charges in accordance with the local tax laws and international tax regulations, and file tax returns prior to statutory deadlines so as to fulfill its obligations to pay tax.
- II. Due consideration shall be given to the Cathay FHC’s overall tax burden and the impact on its reputation, management of risks, and social responsibilities in achieving an overall optimal tax policy, as the tax risks and the response measures.
- III. Tax-relevant information will be disclosed publicly to stakeholders on a regular basis to ensure transparency.
- IV. Cathay FHC shall foster a mutually trustworthy and honest relationship with the tax authorities. Where possible, it will provide practical industry views and market insights to improve the tax environment and tax system.
- V. Cathay FHC shall ensure that its employees receive regular training, both domestic and foreign, in order to enhance their competencies with regard to tax governance.

Cathay FHC aims to optimize overall taxes and has a few supplementary statements:

- Cathay FHC does not attempt to transfer profits to countries with low tax rates.
- Cathay FHC does not attempt to transfer profits to tax havens.
- Cathay FHC does not attempt to create a complex tax structure for tax evasion.
- Cathay FHC does not intentionally arrange abnormal transfer pricing. Our transfer pricing complies with local tax laws and international standards.

Cathay FHC carefully assesses related tax risks and response measures for subsidiaries located in tax jurisdictions with low tax rates. Tax management units and the Risk Management Division furthermore submit tax management reports to the Board of Directors on a periodic basis.

For Cathay FHC’s tax governance policy, please click on the link below:

[Cathay Financial Holdings Tax Governance Policy](#)

- **Implementation of Tax Governance**

I. Overview of Cathay FHC's global operations and tax payment

Cathay FHC complies with local tax laws of business locations around the world by calculating taxes due accurately and filing tax returns by statutory deadlines. Cathay FHC's net operating income was NT\$473.9 billion, pre-tax net profit was NT\$55.6 billion, and corporate income tax paid worldwide was NT\$12.4 billion in 2018. In 2018, 97% of our net operating income, 98% of our pre-tax profit, and 93% of income tax paid were in Taiwan, which is our main country of operation. See Table 1 below for the amount and percentage accounted for by each country.

Table 1: Percentage of Revenue, Operating Profits, and Taxes Paid in Each Country in 2018

Unit: NT\$ billion, %

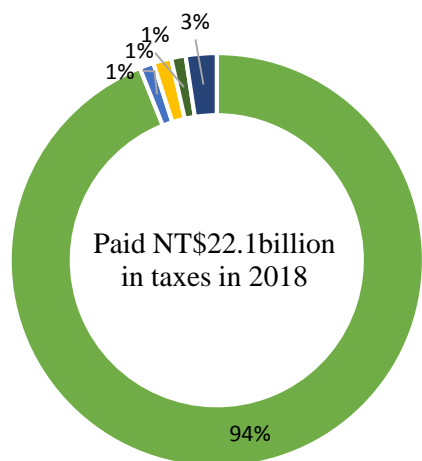
By country	2018					
	Revenue (Note 1)	%	Operating Income (Note 2)	%	Income Tax Paid	%
Taiwan	463.1	97.7%	54.5	98.0%	11.5	92.8%
China	3.1	0.7%	1.1	2.0%	0.1	1.0%
Vietnam	2.2	0.5%	0.2	0.4%	0.2	1.8%
United Kingdom	5.0	1.0%	(0.3)	(0.7%)	0.2	1.4%
Other Countries	0.5	0.1%	0.1	0.3%	0.4	3.0%
Total	473.9	100%	55.6	100%	12.4	100%

Note 1: "Revenues" were disclosed as "Total income" in the financial statement due to Regulations Governing the Preparation of Financial Reports by Financial Holding Companies.

Note 2 : "Operating income" were disclosed as "Profit before income tax from continuing operations" in the financial statement due to Regulations Governing the Preparation of Financial Reports by Financial Holding Companies.

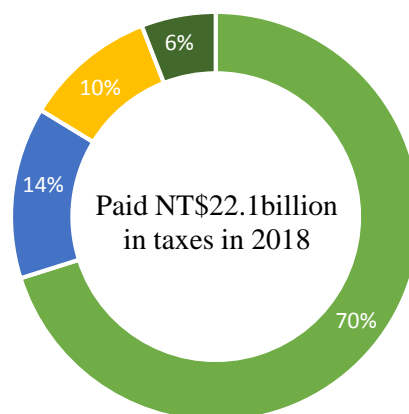
Cathay FHC paid NT\$22.1 billion in taxes worldwide in 2018. The amount of taxes paid in Taiwan account for 94% of taxes paid worldwide due to the fact that Taiwan is our main country of operation (see Table 2 for details). Major tax categories included corporate income tax, business tax, and house and land tax (see Table 3 for details).

Table 2: Taxes paid and collected by country



■ Taiwan ■ China ■ Vietnam ■ UK ■ Others

Table 3: Taxes paid and collected by type



■ Corporate income tax ■ Business tax
■ House and land tax ■ Others

II. Description of Cathay FHC's effective tax rate and income tax rate paid

Table 4: Cathay FHC's effective tax rate and income tax rate paid

Unit: NT\$ billion

Item	2018	2017	Calculated Average rate
Profit before income tax from continuing operations (A)	55.60	59.64	57.62
Income tax expense (B)	3.78	2.96	3.37
Effect of changes to tax laws (See Table 5 for details) (C)	3.30	-	1.65
Adjusted income tax expense (D)=B+C	7.08	2.96	5.02
Income tax paid (E)	12.36	8.55	10.46
Effective tax rate (F)=D/A	12.73%	4.97%	8.71%
Income tax rate paid (G)=E/A	22.23%	14.34%	18.15%

The amount of pre-tax profit, income tax expense, and income tax paid is based on Cathay FHC's 2018 consolidated financial statements.

Cathay FHC's average effective tax rate for the past two years was 8.71%, and income tax rate paid was 18.15%. The insurance business is Cathay FHC's main source of profits. Thus, we are categorized under the insurance industry in the Global Industry Classification Standard (GICS). The average effective tax rate of the insurance industry is 21.10% and average tax rate paid is 24.66%. Furthermore, Taiwan's statutory tax rate was 20% in 2018, and 17% in 2017, averaging 18.50% over the past two years.

Cathay FHC's average effective tax rate in the past two years was 8.71%, which was lower than Taiwan's statutory tax rate and the international average effective tax rate. This was mainly because Taiwan's statutory corporate income tax is lower than the international average of 23.03%^{Note}, as well as the relatively high tax-exempt income of subsidiaries. Tax-exempt income includes income from sales of domestic securities, dividend income due to tax integration, and offshore banking unit (OBU) income.

Cathay FHC's average income tax rate paid in the past two years was 18.15%, which is about the same as Taiwan's average statutory tax rate of 18.5%. The main reason it was lower than the international average effective tax rate was because Taiwan's corporate income tax is lower than the international average of 23.03%^{Note}.

In summary, the reasons that our average effective tax rate of 8.71% was lower than the statutory tax rate of 18.5%, as well as the international insurance industry's average tax rate of 21.1%, as well as related amounts are summarized in the table below:

Note: The average statutory tax rate of 208 countries is 23.03% according to 2018 international corporate income tax data surveyed by the Tax Foundation. Link: <https://files.taxfoundation.org/20181127165741/Corporate-Tax-Rates-Around-the-World-2018.pdf>

Table 5 : Factors that affect Cathay FHC's tax rate and explanation

Unit: NT\$ billion

Reason	Tax Impact 2018	Tax Impact 2017	Explanation
Single jurisdiction tax code	(0.40)	(2.27)	<ul style="list-style-type: none"> Effective tax rate Cathay FHC's average effective tax rate for the past two years was 8.71%, lower than the international average effective tax rate and Taiwan's statutory tax rate, mainly because: <ul style="list-style-type: none"> A. Our operations are mainly based in Taiwan, which has a 20% corporate income tax rate (17% in 2017), lower than the international average. B. Relatively high tax-exempt income of subsidiaries. Tax-exempt income includes income from sales of domestic securities, dividend income due to tax integration, and offshore banking unit (OBU) income. Income tax rate paid Cathay FHC's average income tax rate paid in the past two years was 18.15%, which is about the same as Taiwan's average statutory tax rate of 18.5%. The main reason it was lower than the international average effective tax rate was because Taiwan's corporate income tax is lower than the international average.
Tax effect of revenue exempt from taxation	(7.46)	(8.62)	
Accounting adjustments for major tax policy changes	(3.30)	-	Taiwan's corporate income tax was raised from 17% to 20% in 2018, and the effect of the tax rate adjustment on deferred tax asset (DTA) and deferred tax liability (DTL) resulted in a gain of NT\$3.3 billion. The amount was added back when calculating Cathay FHC's effective tax rate (see Table 4 for details) to eliminate its effect and faithfully reflect the effective tax rate.
10% surtax on undistributed retained earnings and others	3.21	1.27	Undistributed earnings tax amount to approx. NT\$1.74 billion each year, and there are also prepaid taxes for overseas investments.

- **Cathay FHC's tax risk assessment and response plan**

Cathay FHC continues to monitor changes to tax laws in Taiwan and overseas, and evaluates the effect of such changes on the group. We actively consult tax experts and the competent authority of taxation whenever we have any questions regarding taxes. This allows us to mitigate factors of uncertainty in our tax planning, minimize tax risks, and achieve tax stability.

We periodically carry out tax risk assessments and response plans for subsidiaries established in tax jurisdictions with low tax rates and transfer pricing. In 2018, we completed the group-wide 2017 master file and country-by-country report in response to the Organization for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS), and filed tax returns to Taiwan's Tax Bureau and the UK. We also completed the group-wide master file for 2018 in March 2019, which was prepared by Cathay Life Insurance (Vietnam) Co., Ltd.