Recent Developments in the OECD's Digital Tax Efforts & Its Potential Impact on Multinational Companies

Recently, the Organization for Economic Cooperation and Development ("OECD") announced its hopes to establish new consensus-based rules for "taxation of digital companies" by 2020.

Earlier this year, Angel Gurria, the OECD Secretary-General, published a proposal to advance international negotiations on digital tax. The plan would essentially reallocate some of the profits of the multi-national companies ("MNCs"). Moreover, the plan would ensure that corresponding taxing rights be given to the countries and jurisdictions, where the the MNCs conduct their "significant" business and make profits, even though they do not have a physical presence there.

The Korean government has established a public-private task force, which includes representation from the Ministry of Economy and Finance, the National Tax Service and related companies, to actively monitor and respond to the OECD digital tax discussion.

While the South Korean government predicts another three to four years before the actual implementation of the plan, once final agreement is reached, it would be prudent for the affected companies to closely monitor the relevant developments, and specifically, those companies that are likely to be directly affected by the expansion in the scope of digital taxation should consider providing its comments through active participation in the private-public task force.

1. Background: What is Digital Tax?

- Digital tax, also known as the “Google tax,” is designed to impose taxes on large MNCs, including global tech companies (some of which are based in the Silicon Valley), wherever they have “significant consumer-facing activities and generate their profits,” regardless of having a permanent place of operation in a particular country.

- It is imposed on the digital sales of MNCs/global tech companies, in addition to corporate tax. Since January 2019, France already passed its own digital tax specifically aimed at a group of approximately 30 tech companies, imposing a 3% digital tax on their online advertising sales. The OCED’s proposal could be broader than this group of 30 companies designated by the French government. Meanwhile, the U.K. is also planning to impose a digital tax beginning in 2020.

- Global tech companies: ① **make a profit without having a permanent place of business** in a particular country; and ② are highly dependent on intangible assets (e.g., data, platform), which may lead to the following issues:

  - **Imposition of a corporate tax on profit generated**, as such companies may make a profit without establishing a physical presence in a particular country; and

  - As the companies are highly dependent on intangible assets, **they may avoid taxes by intentionally transferring their assets to a country, which imposes lower tax rates on intangible assets.**

- Introduction of digital tax is being discussed as taxes on profit earned by consumers across the globe must be collected by each country in which such a profit is generated, and not only by the country where its parent company is located.

2. Key Aspects of the OECD's Recent Discussions

- The below is a summary of the OECD's digital tax imposition plans, which are likely to be adopted:

  - **Taxation principles:** Taking into account that profit earned from digital service is generated through participation of users, tax imposition by the country in which the user is located is being discussed as the most probable taxation principle.

  - **Scope of application:** Initially, **imposition of digital tax only on global tech companies** was discussed. Recently, however, **voices advocating for the expansion of the scope of application to B2C companies have emerged from the U.S. and other jurisdictions.**

  - **Types of business subject to digital tax:** If B2C business is to be subject to a digital tax, then not only conventional tech companies providing online platform and cloud services, but also **MNCs that produce consumer goods (e.g., vehicles, cellphones, home appliances) must also be subject to digital tax.**

  - **Suggestion of a "unified approach" (vs. "global minimu tax"):** Recently, the OECD has suggested a unified approach based on common features of the plans being discussed (including the above plan). Under the unified approach, not only multinational tech companies, but also MNCs doing business with consumers would be subject to digital tax as noted above. This reflects the U.S. government's position that companies selling consumer goods sould also be subject to taxes, based on the concerns that some of the well-known U.S.-based global tech companies would bear most of the burden if digital taxes are introduced under the framework currently being discussed. The reasoning behind this approach is that manufacturers also use social media and online markets to market their producs and generate value, which makes them no different from tech companies regarding digital business. If this unified approach is followed, then large, highly-profitable Korean corporations doing business internationally would also become subject to taxation.

  - The key aspects of the unified approach are:

    ① **Strengthen the taxation right of the jurisdiction in which the company does business (marketplace);**

    ② **Add a new application criteria without depending on a company's physical presence;**

    ③ **Change of the existing independent entity principle; and**

    ④ Promote simplicity and reliable taxation.

3. Implications for Korean Companies Operating Across National Borders

- If the OECD's digital tax imposition principles are finalized in 2020, it is highly likely that **Korean tech companies making a profit from overseas users (by providing services in other countries) will also be subject to digital tax.**

  - Meanwhile, **inclusion of B2C business for digital tax imposition** has been strongly suggested in the recent OECD digital tax discussion. Hence, if B2C business is to be subject to digital tax, it is highly likely that **Korean manufacturers producing vehicles, cellphones, home appliances, etc. for overseas consumers will be subject to digital tax in other countries in which it generates a profit, regardless of whether they have a physical presence.**

How Shin & Kim's TMT and Tax & Customs Practice Groups Can Help:

Shin & Kim's TMT practice group, with unrivaled expertise, deep and wide network in the industry (including former Vice-minister of the Ministry of Science and ICT, Mr. Jae-You CHOI), has been providing both foreign and domestic companies with consulting and advisory services on regulation of TMT industry. The group's highly-specialized professionals continue to analyze regulatory trends and offer comprehensive advice, including on government relations/stakeholder engagement, legislative affairs, regulatory matters, corporate strategies, among others.

Also, **Shin & Kim's Tax & Customs practice group,** which is comprised of tax specialists, including attorneys, tax attorneys, customs brokers, accountants, tax accountants, provides top quality legal advice tailored to our clients' commercial needs. Our professionals are highly experienced in various related areas, including tax consulting, tax disputes, customs duties, including in both the public and the private sectors (**including the former Director of Seoul Regional Tax Office, Mr. Gwang-Jo SONG, former Standing Judge of the Tax Tribunal, Mr. Hyung-Cheol RHO, among many others**).

Should you have any questions about the contents of this newsletter, or if we can otherwise be helpful, please do not hesitate to contact us.

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