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South Korea: Trends & Developments

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Trends and Developments

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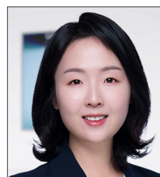

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The Latest Developments in Corporate Tax in South Korea

Global Anti-Base Erosion Tax

On 23 December 2022, South Korea became the first country to incorporate the Global Anti-Base Erosion (GloBE) Rules into domestic law by enacting Articles 60 through 86 of the Adjustment of International Taxes Act (AITA), effective as of 1 January 2024. The first filing and payment is due in June 2026. At the time of the enactment of the legislation, both the Income Inclusion Rule (IIR) and the Under Taxed Payment Rule (UTPR) were planned to be implemented from 1 January 2024.

On 27 July 2023, the government announced the 2023 Tax Revision Bill, and on 21 December 2023, the National Assembly passed the 2023 Tax Revision Bill with some amendments, including supplements to the global minimum tax rules. One significant change in the reform bill was postponing the implementation date of the UTPR by one year to 1 January 2025 to align with the implementation timing for other countries.

Most recently, on 27 February 2024, the amended enforcement decree of the 2023 Tax Revision Bill was announced by the Ministry of Economy and Finance, and is expected to be promulgated and implemented later in March 2024 after legislative preview, consultation with ministries, and examination by the legal authorities. The enforcement decree aims to align the global minimum tax rules with the OECD model rules and commentaries.

South Korea's global minimum tax largely follows the OECD model rules and commentaries, and aims to combat tax avoidance and base erosion by multinational enterprise corporations (MNC) to ensure that MNCs pay a new global minimum tax of 15% on their income.

The global minimum tax applies to MNCs with annual revenue of at least EUR750 million in the consolidated financial statements of the parent MNCs in at least two of the four preceding business years. The parent MNCs whose subsidiaries have low-taxed foreign income must pay a "top-up" tax to increase the tax rate with respect to such income to 15%.

The top-up tax is first imposed under the IIR on the parent MNC if the effective tax rate of all the consolidated companies and branches in each jurisdiction does not reach the minimum tax of 15%. The UTPR is applied when the IIR is ineffective, in which case the top-up tax will be collected by the countries in which other group companies are located.

In addition to postponing the implementation date of the UTPR by one year from 1 January 2024 to 1 January 2025 to align with the implementation timing for other countries, the 2023 Tax Revision Bill expanded the definition of a "permanent establishment" to include a place of business where there is an applicable double tax treaty in force between the state of residence and the source state, and the place of business is treated as a permanent establishment for the purpose of that treaty provided that the source state taxes the income attributable to the permanent establishment. Additionally, in order to ease the implementation burden in the early stages of the global minimum tax rules, the 2023 Tax Revision Bill exempts additional taxes from non-filing, under-reporting, and over refunds, and provides a 50% reduction in additional taxes from late payment for business years starting before 31 December 2026 and ending before 30 June 2028.

The amended enforcement decree of the 2023 Tax Revision Bill announced in February 2024

clarifies the terminology related to companies subject to the global minimum tax, including the scope of covered companies and the criteria for recognising the consolidated financial statements. The amended enforcement decree also establishes a new GloBE information return to report the global minimum tax for the first time in June 2026, and designates countries deemed to satisfy the acceptable financial accounting standards with respect to the GloBE Rules.

Specifically, regarding the clarification of the terminology, under the new rules, the global minimum tax may apply to a smaller company that is not included in the consolidated financial statements if the impact of being included in the consolidated financial statements is not material and if such company is held for sale. Also, to avoid material misstatement, differences from the International Financial Reporting Standards that exceed EUR75 million will be reconciled and treated in accordance with the International Financial Reporting Standards.

In addition, the new rules prescribe certain required adjustments to net income for accounting purposes to ensure the effective implementation of the global minimum tax. These adjustments include the addition of net tax expenses and incremental expenses for intra-group financing arrangements. The amounts applied in intercompany transactions are adjusted in accordance with the arm's length principle and include adjustments in special cases defined by law. Members of MNCs can choose to apply consolidated accounting adjustments in calculating the global anti-base erosion income and loss.

The new GloBE information return will be a globally common return form to report information including taxpayer identification number, country of residence, corporate status, shareholding structure, and effective tax rate by country. Also, the accounting standards recognised by the following countries will be treated as acceptable financial accounting standards for purposes of the global minimum tax: New Zealand, Mexico, the USA, Brazil, Swiss, Singapore, the UK, the EU, EEA member countries, EU member states, India, Japan, China, Canada, Australia, and Hong Kong.

South Korea's global minimum tax may increase the tax burden on Korean companies with overseas operations, with some speculating that the tax credits received in the US by these companies under the Inflation Reduction Act would result in additional tax liability in South Korea. However, it would be difficult for the South Korean government to unilaterally interpret the impact of such credits on the global minimum tax. Accordingly, it is important to be on the lookout for future guidance from the US Treasury as well as the OECD, especially on the issue of the effective tax rate and the tax credits under the Inflation Reduction Act.

Trends

In South Korea, tax audits are conducted on a regular basis and in the event that the taxes imposed are improper or excessive, the taxpayer has the ability to challenge the taxes imposed before the legal court proceedings. After exhausting such option the taxpayer has not been able to come to a favourable result, may court proceedings start. Looking at the current trends of the National Tax Service of Korea (NTS) and issues that are frequently coming up in South Korea, permanent establishment issues of foreign IT companies and taxation of foreign registered patents in South Korea are discussed in detail below.

Permanent establishment of global digital platform companies

NTS imposed taxes on global digital platform companies by arguing that such companies' permanent establishment in South Korea should be recognised. Unlike members of the EU, and the UK, South Korea did not implement the digital service tax. However, the definition of permanent establishment has been broadened under the Corporate Income Tax Act of Korea (CITA) in 2018, reflecting BEPS Action 7 and Article 5 of the OECD Model Treaty.

Even before the amendment to the CITA, the taxing authority in South Korea levied taxes on major global digital platforms in South Korea for fiscal years prior to 2019. For example, in one such case, NTS imposed taxes on a foreign corporation by indicating that a foreign corporation was acting as a provider for the region even though it did not have a permanent establishment in South Korea. The global digital platform company had ancillary places of business in South Korea, and NTS argued that these places combined constituted a permanent establishment of the foreign corporation because they were carrying out essential and important parts of the foreign corporation's business. Even if a physical permanent establishment is not recognised, NTS argued that a deemed permanent establishment should be recognised because some of these places of business exercised the right to conclude contracts and bind the foreign corporation.

Based on such arguments and issues raised during the tax audit, the taxpayer took this case to the tax tribunal, which found in favour of NTS. Thus, the taxpayer has launched legal action against NTS indicating that the basis of taxation is improper and there is no basis for permanent establishment in South Korea. Even if NTS is not successful in the current legal proceedings, due to the amendment to the definition of permanent establishment in 2019, the authors foresee this issue to be raised during tax audits of other global digital platform companies. To date, there are several cases, each at different levels of the legal proceeding or tax audit, which is an indication that this issue will be raised persistently by NTS.

As there is no Supreme Court precedent on this matter, global digital platform companies should be on guard and ready to defend their positions in case of a tax audit by NTS of said issue.

Foreign patent rights

The debate regarding the taxation rights of patents not registered in South Korea is still an ongoing matter. Some of the key events, such as the Supreme Court rulings and legislative reforms have been highlighted below as a recap of the issue and the status quo.

Recap

In 2007, the Supreme Court of Korea (SC) in its decision applied the territorial principle on patents, meaning that patent rights are only effective where the patents are registered. Thus, specific to the facts of such case, only if the licensed patents are registered in South Korea by a US corporation and licensed to a South Korean resident for use in South Korea may it be considered domestic-source income as defined under the United States–Republic of Korea Income Tax Convention ("US–Korea tax treaty"). To put it another way, royalties received by a US taxpayer from a Korean corporation are not considered to be domestic-source income if the licensed patent is registered only in the US and not in South Korea.

In 2008, after such decision was rendered by the SC, NTS amended the CITA, specifically Article 93, to state that the "use" of patents in South

Korea that are registered overseas for manufacturing and sale are considered to be domestic-source income, meaning that even if the patents are not registered in South Korea, they may still be considered to be domestic-source income.

After the amendment, in 2014, there was another decision rendered by the SC, which reaffirmed the intent of the previous SC decision and held that royalties received by a US taxpayer for patents licensed to a South Korean corporation and registered overseas did not constitute domestic-source income, as prescribed under Article 6 and Article 14 of the US–Korea tax treaty. As a result, the royalty income that was received for such patents was not subject to withholding tax in South Korea. This ruling indicated that regardless of the amendments to the CITA in 2008, the withholding tax imposed by NTS on the patents registered in the US was unreasonable.

After a series of SC rulings, which provide clear guidance with respect to refund of withholding taxes for royalties of foreign registered patents, NTS is persistent in its approach and continues to levy taxes on the royalty income in South Korea and at the level of the tax tribunal, such cases are being ruled in favour of NTS due to what the law prescribes as domestic-source income. Additionally, in 2019, Article 28 of the AITA was amended to delete the concept where tax treaties take precedence over domestic tax law when classifying income as domestic-sourced. Article 28 of the AITA was one of the legislations referenced in the SC ruling as to why the US–Korea tax treaty should take precedence over the CITA.

Then in 2022, another case was brought to the SC regarding the issue of taxes withheld on royalty income on foreign patents. Although still aligned with the past rulings, the SC took a narrower approach to the interpretation of its past rulings to encompass legally defined patents registered overseas. The SC held that patent holder's exclusive right to exercise a patent is effective only in the country that it is registered, and furthermore, that the patent right cannot be considered to be "used" in a country to which it is not registered because infringement of such patent may only occur in the country to which it is registered. It essentially allows NTS to withhold taxes on royalty income on unregistered rights such as know-how, copyright, and goodwill, as long as the unregistered rights are used in South Korea. Essentially, the SC has indicated that only unregistered patent rights in South Korea may reap the benefits of the US–Korea tax treaty, which puts the taxing right to the US and not South Korea; all else, NTS may assess tax. Thus, in a sense the taxpayer won on the issue of unregistered patents in South Korea, however, all else is still up in the air for grabs by NTS.

Looking Forward

The timeframes at issue for the cases that have come up to the SC are all before the amendments to the CITA and AITA. Currently, there are cases pending at the administrative court and high court that are on the same issue of the withholding tax on royalty income on foreign patents. It is clear from the most recent SC decision what is considered to be a foreign registered patent. It is likely that NTS will continue to bring up this issue in the tax audits and argue that the consideration paid is for know-how, non-public information or copyright, which constitutes domestic-source income. Thus, bearing all this in mind, it is important when entering into licensing agreements to distinguish and clarify what the royalties are being paid for, whether it be purely foreign patent rights or the use of know-how or other non-public information.

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