Supreme Court Clarifies Treaty Benefits for U.S. LLCs and Patent Transfer Proceeds Under the Korea–U.S. Tax Treaty

(Supreme Court Decision 2024Du65607 rendered on April 9, 2026)

Overview

The Supreme Court of Korea recently addressed two significant issues under the Korea–U.S. Tax Treaty: first, whether U.S. limited liability companies organized as fiscally transparent entities may claim treaty benefits in their own right; and second, whether proceeds received from the transfer of patent rights should be characterized as royalty income or gains from the transfer of property.

The taxpayers were Delaware LLCs in a multi-tier investment structure that included several intermediate LLCs and limited partnerships. In 2014 and 2015, the taxpayers transferred semiconductor-related patent rights to a Korean semiconductor company for approximately USD 6.4 million. The transfer agreements provided for fixed consideration.

The taxpayers contended that the proceeds were not subject to Korean taxation under the Korea–U.S. Tax Treaty. The National Tax Service, by contrast, treated the payments as royalty income subject to Korean withholding tax.

The dispute therefore turned on two principal questions. The first was whether the LLCs qualified as U.S. residents entitled to treaty benefits notwithstanding their fiscally transparent status. The second was whether the fixed consideration paid for the patent transfers constituted royalty income or gains from the transfer of property.

The lower court ruled in favor of the taxpayers. It accepted treaty entitlement based on certificates of residence issued by the U.S. Internal Revenue Service and concluded that the patents constituted “capital assets” under the Korea–U.S. Tax Treaty, with the result that the gains were exempt from Korean taxation.

Court’s Decision

The Supreme Court reversed the lower court's reasoning in part and reaffirmed Korea's look-through approach to fiscally transparent entities. The Court held that a fiscally transparent entity is not, merely by virtue of its organization in the United States, treated as a U.S. resident for treaty purposes. Rather, treaty benefits are available only to the extent that the relevant income is treated as income of members or investors who are themselves U.S. tax residents and subject to U.S. taxation on that income.

On that basis, the Court held that a letter of U.S. residency certification issued by the U.S. Internal Revenue Service ("IRS") in the name of an LLC alone is insufficient to establish treaty entitlement. Taxpayers relying on treaty benefits through fiscally transparent entities must be able to substantiate the residence and tax status of the ultimate members or investors with respect to the relevant income.

The Court then turned to the characterization of the patent transfer proceeds. Under the Korea–U.S. Tax Treaty, consideration for the transfer of intellectual property is treated as royalty income only where the amount payable is contingent on the productivity, use, or disposition of the relevant intellectual property. By contrast, the fixed consideration determined at the time of the transaction is more appropriately characterized as consideration for the transfer of property, rather than as royalty income.

Applying that principle, the Court concluded that the payments at issue were not royalties. The price had been fixed in advance and was not dependent on the future performance, productivity, use, or exploitation of the patents.

The Court nevertheless rejected the taxpayers' further argument that the gains were automatically exempt as gains from the transfer of "capital assets" under the treaty. The term "capital assets" is not defined in the Korea–U.S. Tax Treaty, and the Court found no corresponding definition in Korean domestic tax law that resolved the issue. In those circumstances, the Court interpreted the term by reference to U.S. tax law, reflecting the treaty context in which the term was used.

Under the U.S. Internal Revenue Code, property used in a trade or business and subject to depreciation or amortization is generally excluded from the definition of a capital asset. Because the patents at issue fell within that category, the Court held that they did not qualify as capital assets for purposes of the treaty.

As a result, the gains were not automatically exempt under the treaty's capital gains provision. The taxability of the proceeds instead had to be determined by applying the relevant source rules under the treaty, including rules concerning the place of sale of the patent rights.

Practical Implications

The decision is significant for both treaty entitlement and income characterization.

First, the Supreme Court has reaffirmed Korea's look-through approach to fiscally transparent entities, establishing that treaty benefits are not granted merely because an LLC is organized in the United States or holds a letter of U.S. residency certification issued by the IRS in its own name. Instead, taxpayers must be prepared to demonstrate that the underlying members or investors are U.S. tax residents and are subject to U.S. taxation on the specific income for which treaty benefits are claimed.

This aspect of the decision is particularly relevant for multinational investment structures involving LLCs, partnerships, and other transparent or hybrid entities. Taxpayers using such structures should ensure that they maintain sufficient documentation regarding ownership, investor residency, and tax liability at the investor level. In practice, entity-level residency certificates may not be sufficient if the entity is deemed fiscally transparent.

Second, the decision provides useful guidance on the distinction between royalties and proceeds from the transfer of intellectual property. Fixed consideration paid for an outright transfer of patent rights should generally be treated as transfer proceeds rather than royalty income. In contrast, contingent consideration tied to future productivity, use, or exploitation of the intellectual property may be characterized as a royalty.

Third, the Court's interpretation of the undefined treaty term "capital assets" is noteworthy. When a treaty term is not defined in the treaty and Korean domestic law does not provide a clear corresponding definition, the Court may look to the domestic law of the other contracting state to determine its meaning. This rationale may have implications beyond patent transfers and could influence the interpretation of other undefined terms in Korea's tax treaties moving forward.

For multinational groups engaged in intellectual property transfers, licensing arrangements, and cross-border investment structures, the ruling highlights the importance of carefully documenting both the legal form and the economic substance of the transaction. In particular, ownership chains, investor-level treaty eligibility, the fixed or contingent nature of consideration, and the place of sale may all serve as decisive factors in determining the Korean tax treatment of cross-border intellectual property transactions.

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