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Recent Developments in International Taxation

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Recent tax law changes for 2020

The tax law proposals issued by the Ministry of Economy and Finance passed the Korean National Assembly on 27 December 2019. The main changes to the tax law involving foreign corporations, foreign invested corporations or cross-border transactions are addressed below. The changes took effect from 1 January 2020, unless otherwise stated.

Corporate Income Tax Act (CITA)

Re-characterisation of the taxation system of royalties generated from patents not registered in Korea

To date, the Korean Supreme Court (KSC) has held that royalty payments with respect to patents unregistered in Korea are not Korean-sourced income when the Place of Usage-Based Tax Treaty applies. Unlike the position of the KSC, the revised CITA stipulates that where the Place of Usage-Based Tax Treaty applies: (1) consideration paid for the use of intellectual property (eg, patents, utility models, trademark and designs) that are unregistered in Korea but where the manufacturing methods, technology and information are utilised in Korea is characterised as royalty income sourced in Korea (Article 93(8)); and (2) consideration paid for the infringement of rights pertaining to intellectual property that is unregistered in Korea may be characterised as 'other like property or rights' and deemed to be sourced in Korea to the extent that the manufacturing methods, technology and information are utilised in Korea (Article 93(10)).

However, because tax treaties usually take precedence over domestic tax law, it remains to be seen whether the

KSC will change its existing position merely because domestic tax law has been revised, even though there has been no change in the tax treaty. The revised tax law applies to income paid after 1 January 2020.

Expansion of the scope of income and deductible expenses attributable to a domestic place of business

The revised Enforcement Decree of the CITA ('ED-CITA') expands the scope of domestic source business income. Under the previous ED-CITA, income accruing from business activities conducted in Korea and certain income accruing from outside Korea but attributable to a place of business in Korea was deemed as Korean sourced income if such income was derived from the following: (1) investment in foreign securities or lending money to a foreigner or from other similar acts; (2) a lease granting a permit to use, transfer or exchange assets or rights overseas; or (3) the issuance, acquisition, transfer or exchange of stocks, bonds and other assets overseas. Article 132 (3) of the amended ED-CITA stipulates that, as a rule, all income that originates from outside Korea but is attributable to a place of business in Korea should be included within the scope of domestic source business income.

On the other hand, the revised ED-CITA expanded the scope of deductible expense recognition for a domestic place of business in Korea. Article 130 (2) of the amended ED-CITA stipulates that: (1) provided the costs associated with transactions between the domestic place of business and overseas headquarters and other branches are reasonably allocated in relation to the occurrence of domestic source income within the range of the normal price, they are to be included as deductible expenses, regardless of the actual expenses; and (2) interest expenses arising from capital transactions involving borrowings for business activities in relation to Korean source income at a place of business in Korea may also be recognised as deductible expenses in accordance with relevant tax treaties.

Basic National Tax Act (BNTA)

Unification of the right to claim refunds by foreign corporations subject to withholding tax

In accordance with Article 45-2(4) of the BNTA, non-residents or foreign corporations were independently able to file refund tax claims with respect to Korean source income subject to the withholding and payment of tax in Korea by the withholding taxpayer to the extent that such a tax payment was made and a payment statement submitted to the competent tax office by the deadline.

However, Article 45-2(4) of the revised BNTA, in principle, unified the right to claim refunds by stipulating that only withholding agents may file refund claims. Foreign corporations or non-residents may independently file requests where: (1) the withholding agent is subject to bankruptcy or business closure; or (2) the person subject to the withholding made a reasonable request for the filing of the refund claim with the withholding agent, but the withholding agent has not responded.

However, a beneficial owner of income may still file a request for a refund claim under the Individual Income Tax Act or CITA in certain instances. In other words, the beneficial owner of income may file a refund claim independently in cases involving: (1) non-taxation or exemption under tax treaties; (2) non-application of reduced tax rates and application of other reduced tax rates; or (3) post-transaction need to file a refund claim (Articles 98-4, 98-5 and 98-6 of the CITA, and Articles 156-2, 156-4 and 156-6 of the IITA).

Adjustment of International Taxes Act (AITA)

Rationalisation for the allocation of the burden of proof in roundabout transactions

In an international transaction, if it is deemed that both parties have conducted the transaction either indirectly through a third party or via at least two acts or transactions to benefit wrongfully from tax treaties and AITA

('roundabout transactions'), the tax treaties and AITA shall apply according to the economic substance of the transaction, assuming that such a transaction has been conducted directly by both parties or such acts, or transactions are a single continuous act or transaction (AITA 2-2 (3)).

The AITA newly enacted Article 2-2(4) and stipulates that, roundabout transactions that decrease the tax burden in Korea by more than 50 per cent require the application of Paragraph 3 based on the assumption that the transaction was made to unfairly receive the benefits of the tax treaty and AITA, unless it can be proven that there is no intention to avoid such taxes by proving a legitimate business purpose or no intent to avoid taxes. However, the above provisions do not apply if the amount of the roundabout transaction is less than KRW 1bn and the amount of tax burden reduced through the roundabout transaction is less than KRW 100m.

Establishment of the basis for estimating tax on the transfer price when international transaction data is not submitted

Article 11(7) of the AITA was newly established to provide justifiable grounds for the taxable authority to reasonably estimate an arm's length price based on data that can be secured by the tax authority, such as data obtained from businesses that operate similar activities, with respect to taxpayers who are required to submit a master file/local file or certain data on the calculation of the arm's length price but fail to submit it by the relevant deadline.

However, the above does not apply if: (1) the data cannot be submitted due to causes such as fire, disaster or theft; (2) the business is in serious crisis and it is very difficult to submit the data; (3) the relevant books and documents have been confiscated by the competent authority; (4) the tax year for a specially related person has not yet been completed; or (5) it takes a considerable amount of time to collect and prepare the data and the data cannot be submitted by the deadline (Article 21 of the Enforcement Decree of the AITA).