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Global Tax Alert

Korea announces 2019 tax reform proposals

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Executive summary

Korea's Ministry of Strategy and Finance announced 2019 tax reform proposals (the 2019 Proposals) on 25 July 2019. Unless otherwise specified, the 2019 Proposals will generally become effective for fiscal years beginning on or after 1 January 2020.

This Alert summarizes the key proposals.

Detailed discussion

Taxation of royalties for patents registered outside of Korea

The 2019 Proposals provide that any payments for manufacturing know-how, technologies, or information contained in patents rights registered outside of Korea that are used in domestic manufacturing or production activities in Korea will be deemed to be Korean source royalty income by recasting such payments as royalties for the use of "other similar properties or rights" under the Korean Corporate Income Tax Law (CITL). The rule applies to payments made on or after 1 January 2020.

Building a better working world

In addition, the 2019 Proposals introduce a new rule that if a Korean entity pays compensation to any patent holder for the infringement of a patent registered outside of Korea, the payment is classified as "other income"' subject to the 16.5% Korean statutory withholding tax rate, including the 10% surtax. The rule applies to payments made on or after 1 January 2020.

Korean source gain on disposition of real property company securities

The 2019 Proposals provide that the term "real property" includes shares of a Korean corporation if the value of real property held by the corporation equals or exceeds 50% of the value of total assets of the corporation (real property holding company). Accordingly, gain on the disposition of the Korean real property holding company shares are Korean source, subject to Korean tax.

This treatment applies to nonresident individuals and corporations.

New requirements for "abusive transactions"

The CITL includes a "substance over form" principle regarding taxpayers who undertake an abusive transaction with the intent to obtain a tax benefit under a tax treaty and the Korean Law for the Coordination of International Tax Affairs (LCITA).

Under the 2019 Proposals, when a transaction reduces the tax liability by an amount specified in the Presidential Decree of the LCITA (e.g., 50%), the burden of proof is placed on the taxpayer to prove that the transaction has a valid business purpose, without an intent of tax avoidance. Failure to meet the requirement results in the transaction being treated as an abusive transaction and subject to tax in accordance with the "substance over form" principle under the CITL.

Installment tax payments on capital gain on in-kind contributions

Under the 2019 Proposals, when a qualified in-kind contribution is made to form a new Korean holding company or convert an existing Korean company to a Korean holding company, any capital gains tax on the contribution will be paid in installments over three years, beginning in the fifth year of the in-kind contribution. This rule applies to in-kind contributions/share transfers occurring on or after 1 January 2022.

Reduction of securities transaction tax

The 2019 Proposals reduce the 0.5% securities transaction tax rate to 0.45% for over-the-counter and unlisted security transactions. The reduced rate applies to transactions occurring on or after 1 April 2020.

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