Executive summary

On 24 December 2018, Korea enacted the 2019 tax reform bill (the 2019 Tax Reform) after it was passed by Korea's National Assembly on 8 December 2018. The 2019 Tax Reform also includes provisions in line with the OECD BEPS Action Plan 7 (Preventing the artificial avoidance of Permanent Establishment Status), among others. Unless otherwise specified, the 2019 Tax Reform will generally become effective for fiscal years beginning on or after 1 January 2019. The Enforcement Decrees, which provide more specific guidance on the laws, are expected to be issued in February 2019.

This Alert summarizes the key features of the new and amended tax laws.

Detailed discussion

Repeal of certain foreign investment tax incentives

On 5 December 2017, the European Union (EU) included Korea on the list of non-cooperative tax jurisdictions, noting a harmful preferential tax regime related to Korea’s foreign investment tax incentives that are only granted to nonresidents. On 23 January 2018, the EU removed Korea from the list after Korea pledged to revise its foreign investment tax incentive rules in line with global standards.
The current law grants a corporate income tax exemption for up to 7 years and certain local tax exemptions for up to 15 years to foreign-investment companies engaging in the new growth sector businesses and in specially designated areas. The 2019 Tax Reform repeals the corporate income tax exemption and will be effective for tax incentive applications filed on or after 1 January 2019. The repeal has no effect on local taxes; accordingly, the tax incentives on local taxes will continue to apply.

Rationalization of taxation on Korean source income of overseas investment vehicles (OIVs)

Definition of a foreign corporation under the Korean tax law
Currently, a foreign entity that has its headquarters or main office in a foreign country (with no place of effective management in Korea) would be treated as a foreign corporation for Korean tax purposes if any of the following conditions are met: (i) a foreign entity which is incorporated under the law of the jurisdiction of establishment; (ii) a foreign entity whose members are all partners with limited liability; (iii) a foreign entity that can take actions based on its own rights or has duties and obligations of its own; or (iv) a foreign entity that is the same or similar to a Korean entity treated as a corporation under the Korean laws.

The 2019 Tax Reform removes condition (iii), causing the members/interest holders of the entity in contrast to the entity itself to be subject to Korean income tax, unless any of the other conditions in the preceding paragraph are also met. The rule will be effective for fiscal years beginning on or after 1 January 2020.

New rule on beneficial ownership on Korean source income of OIVs
The 2019 Tax Reform introduces a new rule that will treat an OIV as a beneficial owner of the Korean source income if any of the following conditions are met: (i) the OIV is subject to taxation in the jurisdiction it resides and there is no intention to wrongfully evade Korean tax on the Korean source income by establishing the OIV in its jurisdiction; (ii) the OIV is unable to substantiate its investors; or (iii) the OIV is deemed as the beneficial owner under a tax treaty. The new rule clarifies the circumstances in which the OIV will be treated as the beneficial owners of the Korean source income and will be taxed in accordance with the domestic tax law or the tax treaty. The rule will be effective for fiscal years beginning on or after 1 January 2020.

Expanded scope of foreign companies’ permanent establishment (PE) in Korea
As a commitment to implement the PE rules recommended by BEPS Action 7, the 2019 Tax Reform reflects contents of the updates to Article 5 (PE) of the OECD Model Tax Convention approved by the OECD Council on 21 November 2017.

More requirements to a non-PE definition
Under the current law, the term PE does not include a fixed place solely for: (i) the purposes of purchasing goods or merchandise for the foreign company; (ii) the purposes of storing goods or merchandise belonging to the foreign company; and (iii) the purposes of maintaining a stock of goods or merchandise belonging to the foreign company for processing by another company. The 2019 Tax Reform adds that the above exemption applies only if the activity of the fixed place is of a preparatory or auxiliary character.

Preventing misuse of specific exceptions to the PE rules
The 2019 Tax Reform introduces a new rule to prevent misuse of specific exceptions to the PE rules. Under the 2019 Tax Reform, even if the activity of a fixed place is of a preparatory or auxiliary character, such fixed place would constitute a PE if any of the following conditions are met: (i) if such fixed place or other place constitutes a PE of the foreign company or its related party, and the activity of such fixed place is complementary to the business activity carried on by the PE of the foreign company or its related party; or (ii) the overall activity resulting from the combination of the activity of the fixed place carried on by the foreign company or its related party constitutes a complementary function and is not of a preparatory or auxiliary character.

Expanded scope of agency PE
A foreign company may be deemed to have an agency PE in Korea if it has a person in Korea, who is authorized to conclude contracts on its behalf and repeatedly exercises such authority, or who is regarded to have such authority. Under the 2019 Tax Reform, a foreign company may be deemed to have a PE in Korea if a person continuously plays the principal role leading to the conclusion of contracts by the foreign company without material modification even if the person has no legal authority to conclude contracts on its behalf.

The 2019 Tax Reform clarifies that the types of contracts that may be deemed to create an agency PE in Korea are contracts executed in the name of the foreign company:
(i) for the transfer of the ownership of, or for the granting of the right to use, property owned by the foreign company; or (ii) for the provision of services by the foreign company.

**Limitation on net operating losses (NOLs) utilization for Korean branches of foreign companies**

Effective for fiscal years beginning on or after 1 January 2017, Korean branches of foreign companies are subject to an 80% of taxable income limitation on utilization of NOLs. The 2019 Tax Reform further reduces the 80% to 60%.

**Expanded scope of electronic services subject to Value Added Tax (VAT) registration**

Nonresidents providing electronic services (e.g., games, sounds, video files, or software) to a non-VAT registrant in Korea (i.e., business-to-consumer transactions) currently must register for VAT purposes using a simplified online VAT registration method and pay the 10% VAT on its supply of electronic services. Under the 2019 Tax Reform, the scope of electronic services includes cloud computing and will be effective for the services provided on or after 1 July 2019.

**Reduced scope of the buyer subject to secondary tax liability in a business transfer**

The 2019 Tax Reform limits the applicability of the buyer’s secondary tax liability in a business transfer transaction only if any of the following two conditions exists: (i) the buyer is a related party of the seller; or (ii) the buyer acquired the business to aid the seller’s tax evasion.

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**Endnotes**

2. Organisation for Economic Co-operation and Development.
4. The local taxes include acquisition tax, property tax and value-added tax, special excise tax and customs duty on imported capital goods.
5. This is an amendment of the Enforcement Decree, which is expected to be issued in February 2019.
6. If the OIV is able to substantiate only a portion of its investors, then the OIV would be treated as the beneficial owner of the Korean source income to the extent of the Korean source income attributable to those investors that the OIV is unable to substantiate pursuant to the Korean domestic tax law.
8. This is an amendment of the Enforcement Decree, which is expected to be issued in February 2019.
9. Renting web storage space or stored software at a centralized computer that is connected to internet server.
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