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Global Anti-Base Erosion Model Rules (Pillar Two) in Korea

15 November 2023

Introduction

In December 2022, global minimum tax rules were incorporated into the Law for the Coordination of International Tax Affairs in Korea ("LCITA"), aligning with the Global Anti-Base Erosion ("GloBE") Model Rules (Pillar Two) established by the OECD. These rules will become effective on or after January 1, 2024.

The newly introduced global minimum tax rule aims to address tax avoidance related to base erosion and profit shifting by multinational enterprises (MNEs), ensuring that large MNEs pay an appropriate level of taxation on their income.

The revised LCITA in 2022 introduced key points of the global minimum tax rules. The Korean government aimed to address technical issues outlined in the OECD Model Rules, the explanatory Commentary, and the discussions from the OECD/G20 Inclusive Framework through the revision of the following Presidential Decree and the Enforcement Rules of the LCITA within 2023.

On July 27, 2023, the Korean government announced the reform bill including supplements to Korea's current global minimum tax rules.

As a significant change in the reform bill, while the implementation date of the Income Inclusive Rule (IIR) remains the same as January 1, 2024, the implementation date of the Undertaxed Payment Rule (UTPR), is postponed by one year to January 1, 2025. This decision considers the following factors:

- Concerns about potential instability in the inbound investment environment that could arise from introducing the UTPR before other countries.
- The anticipated UTPR implementation date for other countries planning to adopt global minimum tax rules (such as the EU, U.K., Japan, Canada, Singapore, Hongkong, Australia, New Zealand, etc.) is also set for 2025 or later.

**The definition of IIR and UTPR will be explained later in the section on "Charge of additional top-up tax".*

Furthermore, the reform bill in 2023 includes certain revisions to align with the technical guidance for implementing the global minimum tax rules released by OECD.

Additionally, to alleviate the compliance burden during the initial implementation, during the transition period (fiscal year commencing on or before December 31, 2026, and ending on or before June 30, 2028), the following additional taxes and penalties shall be exempted or reduced.

- Exemption from additional tax for non-reporting, underreporting, etc.
- 50% reduction in late payment interest charge.
- Exemption from penalties for non-compliance with the obligation to file a GloBE information return if appropriate measures stipulated in LCITA are taken.

This tax reform bill in 2023 was confirmed by the Korean government on August 29, 2023, and was submitted to the National Assembly in Korea for further review and approval clearance.

Below is a summary of global minimum tax rules in LCITA.

Scope and Taxpayers

- The global minimum tax rules shall apply to constituent entities of MNE Groups whose annual consolidated revenues in at least two of four preceding fiscal years equal or exceed EUR 750 million.
- Certain entities generally exempt from taxes for policy purposes, such as governmental entities, international organizations, non-profit organizations, and pension funds, are excluded entities and are not subject to the application of the global minimum tax rules.
- Domestic constituent entities are required to pay an additional top-up tax allocated in accordance with IIR and UTPR specified in LCITA.

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Effective Tax Rate and Additional Top-up Tax

- The Effective Tax Rate ("ETR") is used to determine whether in a fiscal year, the MNE group is subject to a minimum level of tax on its income arising in a particular jurisdiction and if the jurisdiction's ETR is below the Minimum Rate (15%).
- The ETR for each jurisdiction shall be calculated as the sum of (1) the 'Adjusted Covered Taxes' of each constituent entity located in the jurisdiction for the fiscal year divided by (2) the 'net GloBE income' of the jurisdiction. The income and taxes of Investment Entities such as investment funds located in a jurisdiction are excluded from the ETR computation for that jurisdiction and separate ETR shall be calculated.

  (1) The adjusted covered taxes of a constituent entity for a fiscal year shall be computed by the current tax expenses that are accrued in its financial accounting net income or loss with respect to covered taxes for the fiscal year, adjusted by total deferred tax adjustments, etc.
  (2) The net GloBE income is the sum of GloBE income and GloBE losses of all constituent entities located within the jurisdiction. The GloBE income or loss of a constituent entity is calculated by adjusting net tax expenses (addition) and dividend income (deduction), among other factors, based on the financial accounting net income or losses for the relevant fiscal year. The financial accounting net income or losses should be derived from the consolidated financial statements of the ultimate parent entity in accordance with the accounting standard before any consolidation adjustments are applied.

- Additional top-up tax for the jurisdiction for the fiscal year is computed in accordance with the following formula:

  ✓ Jurisdictional top-up tax = (Minimum tax rate (15%) - Effective tax rate for the jurisdiction) × (net GloBE income - substance-based Income exclusion[1]) + additional current top-up tax - qualified domestic minimum top-up tax[2]

  **1. A certain percentage (5%) of the sum of the payroll carve-out and the tangible asset carve-out for a constituent entity in that jurisdiction.*
  **2 Undertaxes paid in the jurisdiction in which the entity is located where the effective tax rate is below the minimum rate (15%) (There is an effect of preventing the transfer of taxation rights by collecting additional top-up tax first in the country where the entity is located.)*

- Additional top-up tax for each entity is computed in accordance with the following formula:

  ✓ Each entity's additional top-up tax = Additional top-up tax for the jurisdiction x [(GloBE income of the entity / sum of Globe income of entities within the jurisdiction)]

○ Company A, located in country X, is the ultimate parent company and owns subsidiaries B1 and B2 located in country Y. The financial information of each company is as follows.

	Company A	**Subsidiary B1**	**Subsidiary B2**
1) Income tax expense	200	50	45
2) Adjustment (i.e., taxes recorded in Equity)	50	5	-
3) The adjusted covered tax (1+2)	250	55	45
4) Net income	800	450	255
5) Adjustment (i.e., net tax expenses)	200	50	45
6) The GloBE income (4+5)	1,000	500	300

○ The ETR in Country Y, where the subsidiaries of Company A are located, is 12.5% (calculated as (55+45)[3)] divided by (500+300)[6)]). And the additional tax amount is 20 (calculated as (15% - 12.5%) × (500+300)[6)]).

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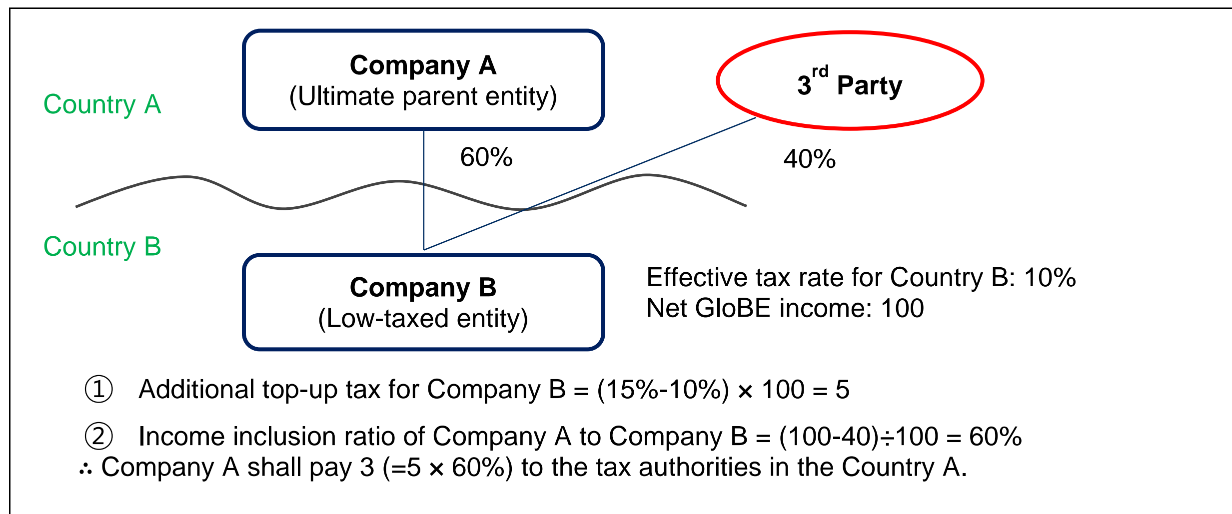
Charge of Additional Top-up Tax

The charging provisions are made up of two interlocking rules, the "Income Inclusion Rule (IIR)" and the "Undertaxed Payment Rule (UTPR)".

Application of the IIR

- Under the IIR, the ultimate parent entity shall pay the allocated additional top-up tax of the low-taxed constituent entity (LTCE) first, and if it cannot be imposed on the ultimate parent entity, the next-tier intermediate parent entity shall pay.
- In split-ownership structures, if a partially owned parent entity (POPE[3]) holds shares of the LTCE, the POPE shall pay the additional top-up tax allocated.
  **3) POPE: 3rd party intermediate parent entities having directly or indirectly significant (i.e., more than 20%) minority interest of the LTCEs outside the MNE group.*
- Top-up tax for LTCEs shall be allocated to the parent entity applying the IIR by the parent entity's inclusion ratio. The inclusion ratio is the ratio of the parent entity's share of a LTCE's GloBE Income to its total GloBE Income for the Fiscal Year.



Application of the UTPR

- In cases where the IIR cannot be applied because the ultimate parent entity is low-taxed or the country where the ultimate parent company does not introduce the qualified IIR, the county where subsidiaries of MNE are located can impose the top-up tax allocated that is not subject to the IIR.
- The total UTPR top-up tax amount shall be allocated to each UTPR jurisdiction (i.e., Korea) based on the following formula:
  - ✓ Domestic UTPR top-up tax = 50% x (the total number of employees of domestic constituent entities / the total number of employees of constituent entities of an MNE group located in all countries where the qualified IIR are in effect) + 50% x (the total net book value of tangible assets of domestic constituent entities / the total net book value of tangible assets of constituent entities of an MNE group located in all countries where the qualified IIR are in effect)
- The domestic UTPR top-up tax shall be allocated to individual constituent entities in proportion to the number of employees and net book value of tangible assets.

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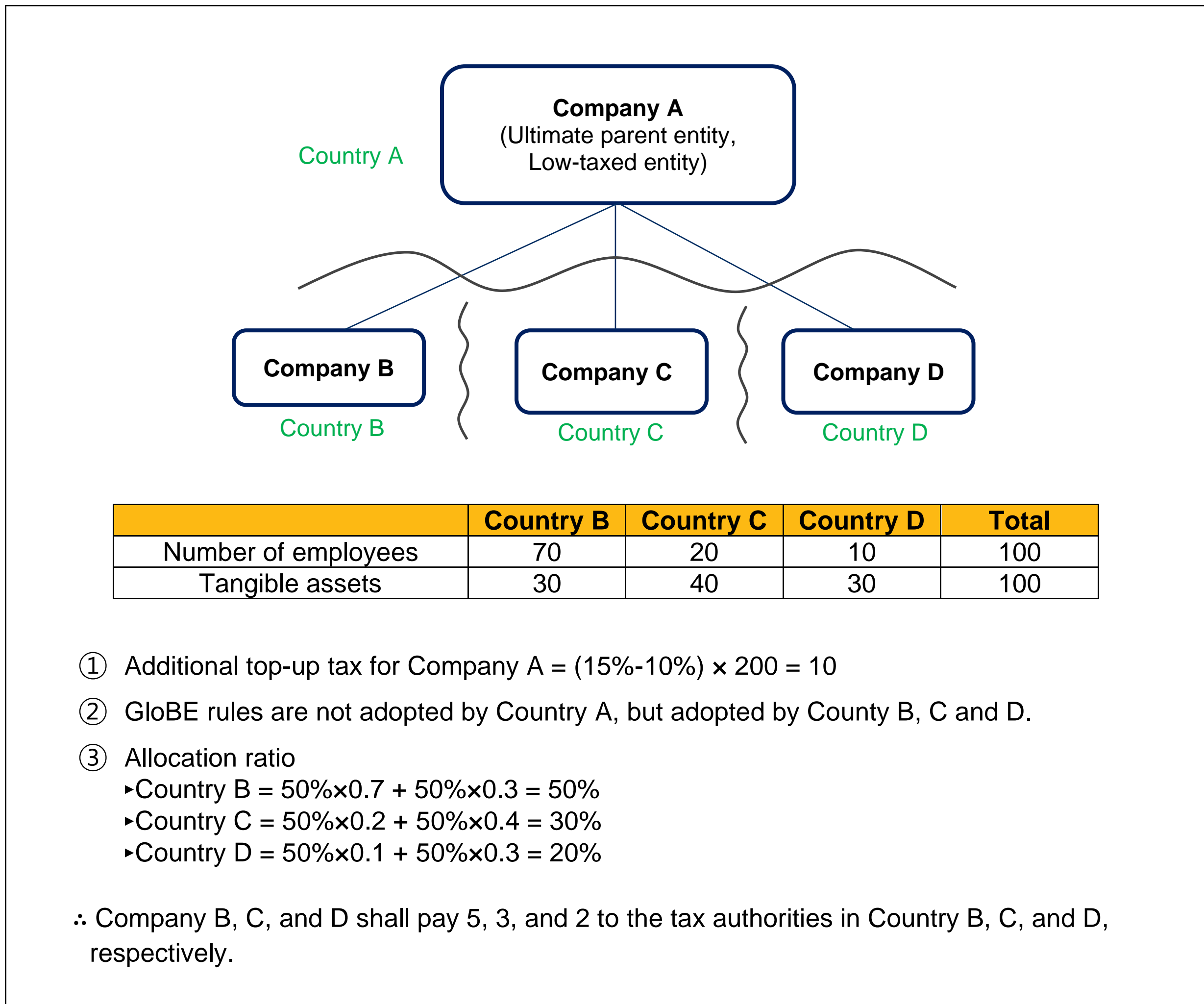

	Country B	Country C	Country D	Total
Number of employees	70	20	10	100
Tangible assets	30	40	30	100

① Additional top-up tax for Company A = (15%-10%) × 200 = 10

② GloBE rules are not adopted by Country A, but adopted by County B, C and D.

③ Allocation ratio
▸Country B = 50%×0.7 + 50%×0.3 = 50%
▸Country C = 50%×0.2 + 50%×0.4 = 30%
▸Country D = 50%×0.1 + 50%×0.3 = 20%

∴ Company B, C, and D shall pay 5, 3, and 2 to the tax authorities in Country B, C, and D, respectively.

Filing and Payment

- Domestic constituent entities are required to file a ‘GloBE information return’ to the tax authorities within 15 months after the end of each fiscal year (18 months after the end of the fiscal year for which the first filing is made).
- They shall also file a report for additional top-up tax allocated and pay the tax amounts to the tax authorities by the filing due date of the GloBE information return.

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