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KPMG Tax Newsletter

Proposed Amendments to the Domestic GloBE Rules

2023 Korean Tax Reform Proposal – Amendments to the Domestic GloBE Rules

On July 27, 2023, the Ministry of Economy and Finance (MOEF) announced tax reform proposals for 2023 ("Tax Reform Proposal"). The Tax Reform Proposal includes amendments to the Korean rules on global minimum tax (the GloBE Rules) which was previously enacted in the International Tax Coordination Law ("ITCL") on December 31, 2022.

Background

In December 2022, the Korean domestic GloBE Rules were enacted and added to Section 5 of the ITCL. Korea was one of the first few countries to codify the GloBE rules in its domestic legislation. The GloBE Rules are aligned with the OECD Pillar 2 Model Rules and includes the Income Inclusion Rule (IIR) and the Under-Taxed Payment Rule (UTPR). Under the currently enacted tax law, both rules are to be effective for fiscal years beginning on or after January 1, 2024.

The technical details of the Model Rules and the Commentary, such as the safe harbor rule, etc., of the Inclusive Framework were planned to be included in the February 2023 amendment of the Enforcement Decree and the Enforcement Regulation of the ITCL. However, the inclusion of these technical details was put on hold to align with the global implementation timeline of the global minimum tax rules. In the midst of this holdup, the MOEF announced the 2023 Tax Reform Proposal.

Highlights of the Draft Tax Amendment in 2023

In the Tax Reform Proposal, the MOEF provided specific details regarding the amendment of the GloBE Rules under the ITCL. The key features of the amendment are as follows:

- The effective date of UTPR will be postponed to fiscal years beginning on or after January 1, 2025. The effective date of the IIR remains unchanged, starting from fiscal years beginning on or after January 1, 2024.
- The Tax Reform Proposal incorporates certain elements of OECD GloBE Model Rules and Commentary that were not included in the original enactment of the GloBE rules under the ITCL in December 2022. The Tax Reform Proposal also adopts key elements of the Administrative Guideline (AG) published by OECD on February and July of 2023.
  - Government body will be excluded from the definition of "Entity" and will not be subject to the GloBE rules.
  - The definition of Permanent Establishment will be specified in line with Article 10.1 of the GloBE Model Rules.

- The definition of the Ultimate Parent Entity will be expanded to include a Main Entity with a Permanent Establishment and exclude sovereign wealth funds.
- The average foreign exchange rate for the December month of the previous fiscal year should be used when converting the GloBE application threshold amount in EUR to KRW under the Model Rules.
- Under the current ITCL, a Filing Constituent Entity could elect not to treat an Entity as an Excluded Entity under Article 1.5.1 and 1.5.2 of the OECD Model Rules. However, under the Tax Reform Proposal, a Filing Constituent Entity may only elect among the excluded entities listed under Article 1.5.2. of the OECD Model Rules.
- Introduction of a special provision for allocating the income or loss of a Permanent Establishment to the GloBE income or loss of the Main entity (in accordance with Model Rules Article 3.4.5).
- Regarding the Post-filing provision in Article 4.6 of the OECD Model Rules, the current ITCL only allows for a true-up of the Covered Taxes (numerator), but the tax reform proposal includes a provision for a true-up of the GloBE income or loss (denominator) as well.
- Introduction of the elective Excess Negative Tax Expense Carry-forward rule that limits the possibility of an MNE having a top-up tax percentage higher than 15% (which would result from subtracting the negative ETR from 15%) - In a year when the GloBE ETR is determined to be negative in a jurisdiction, any Excess Negative Tax amount will be carried forwarded to reduce the ETR in a later year. Such provision is based on Section 2.7. Excess Negative Tax Expense Carry-forward of the AG announced in February 2023.
- Implementation of Safe Harbor rules for Qualified Domestic Minimum Top-up Tax (QDMTT) under the AG published in July 2023 (Recognition of Acceptable Financial Accounting Standard in the QDMTT jurisdiction, allowance of the computation under GloBE rules if Top-up tax is higher than the tax under the GloBE Rule, etc.)
- For the payment of allocated UTPR Top-up Taxes among the CEs in the same Jurisdiction, the filing CE may choose one or more CEs in the same jurisdiction which will pay the UTPR Top-up tax.
- For the payment of allocated UTPR Top-up Tax among countries that have adopted UTPR, if one of the Constituent Entities in a particular country fails to pay its allocated UTPR Top-up Tax, the unpaid tax will not be allocated among the CEs in that country. Instead, the unpaid tax amount will be reallocated to the CEs in other UTPR countries.
- In the case of GloBE Reorganization, if a CE of Multinational Enterprise (MNE) group is required or permitted to gross up the basis of its asset and liability to fair market value for tax purposes in the jurisdiction in which the CE is located, then it is also allowed to be used as a basis for GloBE rules. (In accordance with the Model Rules Article 6.3.4 Election)
- If an investment entity is a tax-transparent entity, the elections under Model Rules Article 7.5 and 7.6 (e.g., the Investment Entity Tax Transparency Election and the Taxable Distribution Method) will not be applied.
- Introduction of Penalty Relief provision during the transition period (fiscal years starting December 31, 2026 and ending before June 30, 2028) in accordance with the Safe Harbor and Penalty Relief rules announced in December 2022.

  - During the transition period, non-filing and under-reported penalties are waived, and underpayment penalties are reduced by 50%

  - During the transition period, if the MNE has taken "reasonable measures" to comply with the GloBE Rules, the non-filing penalty for the GloBE Information Returns will be limited to KRW 100 million under the current tax law.

- Special extension provision for the statute of limitation for tax assessment:

In the event of a change to the effective tax rate for the GloBE Rules, tax authorities will have an additional one-year period to assess tax.

Key Takeaways

The Korean government proposed to defer the implementation of the UTPR by one year, and it will be effective from January 1, 2025. This proposal is expected to relieve the compliance burden of MNEs headquartered in countries where implementation of the IIR is being delayed, such as the United States and China.

The Tax Reform Proposal clarified certain aspects of the existing OECD GloBE Model rules and incorporated a few guidelines released in the AGs published in February and July 2023. However, it does not fully incorporate the entire Model rules and the AGs such as the Transitional UTPR Safe Harbor included in July AG. These gaps will be addressed through amendments to the Enforcement Decree and the Enforcement Regulation of the ITCL. As the OECD is planning to release additional AGs in November 2023, it is important to monitor the legislative review process for any future revisions which typically takes place at the end of each year.

Despite the above, inbound multinational entities in Korea should begin analyzing the impact of the Global Minimum Tax to minimize any potential tax risk.

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