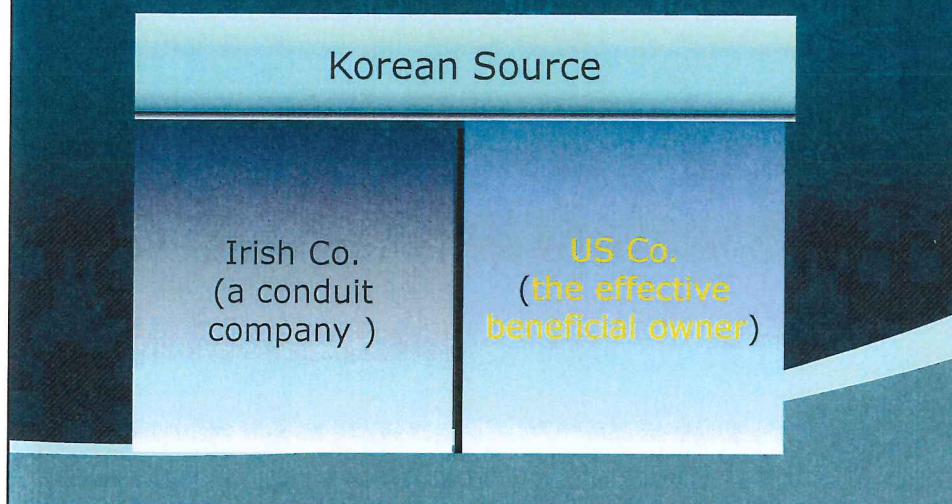


## Supreme Court Ruling: In favor of the tax authority on the First Issue

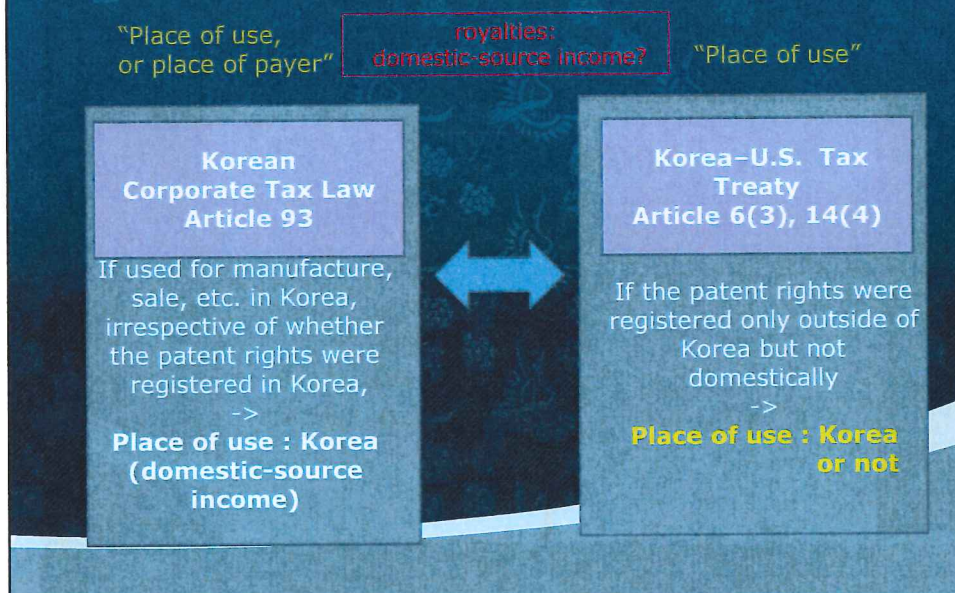


## Supreme Court Ruling: In favor of the tax authority on the First Issue

Factors considered by the Supreme Court:

- (i) The purpose of establishment of Irish Co. and operation status
- (ii) Human and physical resources
- (iii) Decision-making process with respect to transaction
- (iv) Control and management of royalty income

## Second Issue: Whether the royalties for the patent rights which were registered overseas could be domestic-source income



## Supreme Court Ruling: In favor of the tax payer on the Second Issue

- ◆ Article 28 of the Adjustment of International Taxes Act: *the tax treaty shall prevail over the Korean domestic law.*
- ◆ In case where U.S. Co.'s patent rights were only registered outside of Korea, whether the income derived from the patent rights was a domestic-source income should be determined in accordance with the Korea-U.S. Tax Treaty.

## Supreme Court Ruling: In favor of the tax payer on the Second Issue

- ◆ The right to exercise patent for the patent holder to exclusively produce, use, transfer, lend, import, or exhibit the patented goods has effect only within the territory of the country in which the patent right is registered. ("The territorial principle of patent rights").
- ◆ Therefore in case where US Co. has registered its patent only outside of Korea and not domestically, any relevant income paid to US Co. cannot be deemed a domestic-source income.

## CASE 2.



### First Issue:

#### Whether Hungary Co. was the beneficial owner

- ◆ The Korea-Hungary Tax Treaty: No Tax in the State in which the royalties arise. (OECD Model)
- ◆ The Korea-Netherlands Tax Treaty : 15% Tax in the State in which the royalties arise.

#### Korean Source

##### Hungary Co.

: company that entered into a license agreement with CJ E&M

0%

##### Dutch Co.

: company with 100% shares in Hungary Co.

15%

### Supreme Court Ruling: In favor of the tax payer on the First Issue

"A **beneficial owner** is a person who is **entitled to enjoy benefits** of the royalty income received and who is **neither bound by law nor by contract to pass on** the payment to another person."

#### Korean Source

Hungary Co.  
(the beneficial owner)

Dutch Co.

## Supreme Court Ruling: In favor of the tax payer on the First Issue

- ◆ "Given Hungary Co's history and business activities, the details of its activities performed under the agreement with the taxpayer and the details of its expenses and use of funds, *Hungary Co.* appeared to have **enjoyed benefits** of the royalty income **without any legal or contractual obligation to pass on** the payment to Dutch Co."

## Second Issue: Whether the Tax Treaty might be inapplicable according to the domestic GAAR.

- ◆ If treaty abuse was acknowledged according to the **domestic General Anti-Avoidance Rules ("GAAR")**, the Korea-Hungary Tax Treaty might be inapplicable even if constituting a beneficial owner of royalty income.
- ◆ **Article 14 of the Framework Act on National Taxes**  
(1) If any ownership of an income, profit, property, act or transaction which is subject to taxation, is just nominal, and there is other person to whom such income, etc., belongs, the other person shall be liable to pay taxes and tax-related Acts shall apply, accordingly.

## Supreme Court Ruling: In favor of the tax payer on the Second Issue

- ◆ “Hungary Co. actually controlled and managed the distribution rights and the royalty income, just like any other assets it owned.”
- ◆ Factors considered by the Supreme Court:
  - (i) Viacom Group’s business history in Hungary
  - (ii) Hungary Co.’s business divisions and long-term business activities
  - (iii) human and physical resources
  - (iv) details on control, management, and disposition of distribution rights and royalty income

## Review of the two cases

- The Supreme Court tried to interpret the B.O. Provision in the tax treaties as its own meaning under its context, in the light of its object and purpose, and interpret it in harmony with domestic law.
- The Supreme Court has confirmed that in case where treaty abuse was recognized according to the domestic GAAR, the tax treaty might be inapplicable even if constituting a beneficial owner of royalty income.



**Thank you.**

If you have any questions,  
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