

Tax Withholding on Personal Service of Non-Resident

Aug. 3, 2015

1. Overview

The purpose of this review is to verify the tax withholding matters in Korea for a non-resident individual with an US citizenship (who is not employed) on the payment for the individual's supervising services which were provided for the business of an Enterprise in Korea.

2. Review Details

(1) Independent Personal Services

It is required to **withhold 22%** of tax on the individual income if an Enterprise has been provided the services from the individual with US Citizenship and paid commission accordingly. In this case, the requirements for being 22% of the independent personal service withholding tax applied are as follows. (Article 18 of Tax Treaty with U.S.A, Article 98-1-2 of Corporate Tax Act in Korea)

- ① The individual is present in Korea for a period or periods aggregating 183 days or more in the taxable year or
- ② Such income exceeds 3,000 United States dollars or its equivalent in Korean won in a taxable year

(2) Know-how

An Enterprise can **withhold 16.5%** of tax on the individual income if an Enterprise paid royalty to the individual for the transfer of individual's know-how, not 22% which is regulated by Corporate Tax Act in Korea. The withholding tax rate 16.5% is the ceiling rate for royalties as stated in Tax Treaty with U.S.A. (Article 14-1 of Tax Treaty with U.S.A)

(*) Following factors should be considered when an Enterprise withhold the royalty.

- ① information or know-how on industrial, commercial or scientific knowledge/experience
- ② information or know-how means all confidential information which already exist before the supply of that type of information which is required for industrial reproduction of products or process regardless it is an object for the intellectual property rights.
- ③ It is considered as personal services which were delivered by a technician (engineer) regardless whether it is standardized professional services or it is not standardized but the professional knowledge or skill, which is generally possessed by service provider in same filed, are utilized.

3. Conclusion

It is required to **withhold 22% of tax from the payment to non-resident upon the individual's services of supervising and coaching for the business of Enterprise** as it is regarded **as a personal service rather than know-how.**

e.g. in case annual payment is KRW68,000,000, an Enterprise should pay the individual KRW53,000,000 with deduction of about KRW15,000,000 (as withholding tax).

(Reference: No. 189, 고용되지 아니한 인적용역비 지급 시 원천징수여부 \ 법인세업무사례 \ 신고&세무실무)

<The related Statute>

TAX TREATY with U.S.A.

Article 18. [INDEPENDENT PERSONAL SERVICES] [Oct. 20, 1979]

- (1) Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity, may be taxed by that Contracting State. Except as provided in paragraph (2), such income shall be exempt from tax by the other Contracting State.
- (2) Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity in the other Contracting State **may be taxed by that other Contracting State**, if:
 - (a) The individual is present in that other Contracting State **for a period or periods aggregating 183 days or more in the taxable year;**
 - (b) Such **income exceeds 3,000 United States dollars or its equivalent in Korean won in a taxable year;** or
 - (c) The individual maintains a fixed base in that other Contracting State for a period or periods aggregating 183 days or more in the taxable year, but only so much of his income as is attributable to such fixed base.

TAX TREATY with U.S.A.

Article 14. [ROYALTIES] [Oct. 20, 1979]

- (1) The tax imposed by one of the Contracting States on royalties derived from source within that Contracting State by a resident of the other Contracting State **shall not exceed 15 percent of the gross amount thereof**, except as provided in paragraphs (2) and (3).
- (2) Royalties derived from copyrights or rights to produce or reproduce any literary, dramatic, musical, or artistic work, by a resident of one Contracting State, as well as royalties received as consideration of the use of, or the right to use, motion picture films including films and tapes used for radio or television broadcasting, may not be taxed by the other Contracting State at a rate of tax which exceeds 10 percent of the gross amount of such royalties.
- (3) Paragraph (1) and (2) shall not apply if the recipient of the royalty, being a resident of one of the Contracting States, has in the other Contracting State a permanent establishment and the right or property giving rise to the royalties is effectively connected with such permanent establishment. In such a case, paragraph (6) (a) of Article 8 (Business Profits) shall apply.
- (4) **The term "royalties" as used in this Article means:**
 - (a) **Payment of any kind made as consideration for the use of, or the right to use**, copyrights of literary, artistic, or scientific works, copy rights of motion picture films or films or tapes used for radio or television broadcasting, patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or **knowledge, experience, or skill (know-how)**, or ships or aircraft (but only if the lessor is a person not engaged in the operation in international traffic of ships or aircraft) ; and
 - (b) Gains derived from the sale, exchange, or other disposition of any such property or rights (other than ships or aircraft) to the extent that the amounts realized on such sale, exchange, or other disposition for consideration are contingent on the productivity, use, or disposition or such

property or rights, The term does not include any royalties, rentals or other amount paid in respect of the operation of mines, quarries, or other natural resources.

- (5) Where an amount is paid to a related person which would be treated as royalty but for the fact that it exceeds an amount which would have been paid to an unrelated person, the provisions of this Article shall apply only to so much of the royalty as would have been paid to an unrelated person. In such a case, the excess payment may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

CORPORATE TAX

Article 98. [Special Cases concerning Withholding or Collection from Foreign Corporations]

- (1) Where any person pays a foreign corporation the amount of domestic source income provided in subparagraphs 1, 2, and 4 through 10 of Article 93 (excluding any resident or non-resident who pays the amount of income provided in subparagraph 7 of Article 93) which is not substantially related to the domestic place of business of the foreign corporation or does not revert to the domestic place of business of the foreign corporation (including an amount paid to a foreign corporation with no domestic place of business), he/she shall withhold, as the corporate tax, the following amounts from the income of the relevant foreign corporation for each business year, and pay it at the tax office, etc. having jurisdiction over the place of tax payment, as prescribed by Presidential Decree, by the tenth day of the month following the month in which the date of withholding falls, notwithstanding Article 97: Provided, That the same shall not apply to income provided in subparagraph 5 of Article 93 which is taxable as domestic source business income under the applicable tax treaty: <Amended by Act No. 11607, Jan. 1, 2013>
- (a) Income provided in subparagraphs 4 and 5 of Article 93: 2/100 of the amount paid;
 - (b) **Income provided in subparagraph 6 of Article 93: 20/100 of the amount paid;**
 - (c) Income provided in subparagraphs 1, 2, 8, and 10 of Article 93: 20/100 of the amount paid (or the amount prescribed by Presidential Decree in cases of the income specified in subparagraph 10 (c) of Article 93): Provided, That it shall be 14/100 of the amount paid in the case of the interest income accrued from bonds issued by the State, a local government, or a domestic corporation among the income specified in subparagraph 1 of Article 93;
 - (d) Income provided in subparagraph 7 of Article 93: 10/100 of the amount paid: Provided, That if the acquisition value and transfer expenses of the assets transferred are verified, an amount equivalent to 10/100 of the amount paid or an amount equivalent to 20/100 of marginal profits on transfer of such assets, whichever is smaller;
 - (e) Income provided in subparagraph 9 of Article 93: 10/100 of the amount paid (referring to "arm's length price" under Article 92 (2) 2 in cases falling under the same subparagraph; hereafter referred to as "amount paid, etc." in this subparagraph): Provided, That if the acquisition value and transfer expenses of the relevant securities are verified under the proviso to Article 92 (2) 1, an amount equivalent to 10/100 of the amount paid, etc. or an amount equivalent to 20/100 of the amount calculated under the proviso to the same subparagraph, whichever is smaller.

CORPORATE TAX

Article 93. [Domestic Source Income]

Domestic source income of a foreign corporation shall be classified as follows: <Amended by Act No.

11128, Dec. 31, 2011>

1. The following income, being interest income referred to in Article 16 (1) of the Income Tax Act (excluding income referred to in subparagraph 7 of the same paragraph), other interest on loans and profits from trusts: Provided, That the same shall not apply to the interest on loans directly obtained by the overseas place of business for the overseas place of business of a resident or a domestic corporation:
 - (a) Income received as payment from the State, a local government, a domestic place of business of a resident, domestic corporation or foreign corporation, or a domestic place of business of a non-resident under Article 120 of the Income Tax Act;
 - (b) Income received as payment from a foreign corporation or nonresident which is substantially related to the domestic place of business of the foreign corporation or non-resident and is included in deductible expenses or incurred expenses for the purpose of calculating the amount of income of such domestic place of business;
2. Dividend income provided in Article 17 (1) of the Income Tax Act (excluding any income provided in subparagraph 6 of the same paragraph) that is paid in Korea by any domestic corporation, any organization deemed a corporation, or any other domestic source and the amount disposed of as dividends under Articles 9 and 14 of the Adjustment of International Taxes Act;
3. Income accrued from real estate in Korea or real estate rights and mining rights, mining concessions or rights to gather earth, sand, and rock, each of which is acquired in Korea, or the transfer or lease of rights to use or develop underground water or other management of underground water: Provided, That capital gains referred to in subparagraph 7 shall be excluded;
4. Income accrued from the rental of a ship, aircraft, registered motor vehicles, construction machinery, or industrial, commercial or scientific machinery/facilities/equipment, and other tools prescribed by Presidential Decree to a domestic place of business of a resident, domestic corporation or foreign corporation, or a domestic place of business of a non-resident referred to in Article 120 of the Income Tax Act;
5. Income prescribed by Presidential Decree and accrued from any business operated by a foreign corporation (including income taxable as domestic source business income under any tax treaty): Provided, That income referred to in subparagraph 6 shall be excluded;
6. **Income accrued from rendering personal services prescribed by Presidential Decree in Korea.** In such cases, where anyone who receives the relevant personal services bears expenses prescribed by Presidential Decree, including airfares, in connection with the provision of such personal services, it refers to an amount excluding such expenses;
7. Capital gains on transfer of any of the following assets or rights: Provided, That this shall be limited where the assets or rights which generate such gains are in Korea;
 - (a) Assets or rights referred to in Article 94 (1) 1, 2, and 4 (a) and (b) of the Income Tax Act;
 - (b) Stocks, etc. (hereafter referred to as "real estate stocks, etc." in this Article) of a domestic corporation, the total amount of asset value provided in Article 94 (1) 1 and 2 of the Income Tax Act of which is at least 50 percent of the total amount of asset of such corporation as at the start

date of the business year in which the date of transfer falls, among the stocks, etc. (including depository receipts or preemptive rights issued on the basis of stocks, etc.; hereafter the same shall apply in this Chapter) of the domestic corporation, which have not been listed on a securities market under the Financial Investment Services and Capital Markets Act;

8. **Where any of the following rights, assets, or information (hereafter referred to as "rights, etc." in this subparagraph) are used or the remuneration therefor is paid in the Republic of Korea, the relevant price and the income accrued from the transfer of such rights, etc.:** Provided, That where the place of use rule applies, under an agreement for preventing double taxation on income, to determine whether the relevant income is domestic source income, the remuneration for rights, etc. used overseas shall not be deemed domestic source income, regardless of whether it was paid in the Republic of Korea. In such cases, rights requiring registration to exercise the rights, such as patent rights, utility model rights, trademark rights, and design rights (hereafter referred to as "patent rights, etc." in this subparagraph) shall be deemed to have been used in the Republic of Korea, irrespective of whether they were registered in the Republic of Korea, if the relevant patent rights, etc. were registered overseas and have been used for manufacture, sale, etc. in the Republic of Korea:
- (a) Copyrights, patent rights, trademark rights, designs, forms, and sketches of works of learning or fine art (including movie film) or secret formulae or processes, film and tapes for radio and television broadcasts and other similar assets or rights;
- (b) Information or know-how related to industrial, commercial, or scientific knowledge and experience;**
9. Income prescribed by Presidential Decree and accrued from the transfer of any of the following stocks, etc. (including real estate stocks, etc. listed on any securities market under the Financial Investment Services and Capital Markets Act), or other securities (including securities as defined in Article 4 of the Financial Investment Services and Capital Markets Act; hereinafter the same shall apply):
- (a) Stocks, etc., and other securities issued by a domestic corporation;
- (b) Stocks, etc. issued by a foreign corporation (limited to those listed on any securities market under the Financial Investment Services and Capital Markets Act), and other securities issued by a domestic place of business of a foreign corporation;

Commentary on Article 93 of CORPORATE Tax

Article 93-132...7 [Classification of Know-how and Independent Personal Services]

- ① **The information or know-how** described in Corporate Tax law article no. 93-9, **means all confidential information which already exist before the supply of that type of information which is required for industrial reproduction of products or process regardless it is an object for the intellectual property rights**
- ② **It is considered as personal services (hereinafter referred to as the "technical assistance services") which was delivered by a technician (engineer) as determined by Article 132-5-4 of enforcement decree of the Corporate Act, regardless whether it is standardized professional service or it is**

not standardized but the professional knowledge or skill, which is generally possessed by service provider in same field, is utilized.

- ③ Information or know-how mentioned on the above ①, will be determined by taking into account the following factors.
1. whether a contract includes a confidentiality agreement or a special tools are secured to keep confidential and not be disclose to third parties.
 2. whether the consideration for the service substantially exceeds the sum of the actual costs incurred in connection with the provision of service and a normal mark-up.
 3. whether a service provider is required to play a particular role in the application of the provided information or know-how by the user or guarantees the result thereof.
- ④ In cases where a technical contract, on which domestic enterprises settle with foreign enterprises, involves both the transfer services for above ① Information or know-how and ② technical assistance services, the income should be calculated as follows.
1. where one part of what is being provided constitutes by far the principal purpose of the contract, and the other parts stipulated therein are only of an ancillary and largely unimportant character, the income characterization of the principal part should be generally be applied to the whole amount of the consideration.
 2. other than above article 1, the total payment should be calculated and for payment for information or know-how or payment for technical assistance service each, by using reasonable apportionment criteria such as the quantum of information/know-how provided under the contract, hours' of work, remuneration per week, etc.