Introduction of BEPS 2.0 and Securing transparency in Korea

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01 INTRODUCTION

Corporate Tax Avoidance (CTA) of Multinational Corporations (MNC) consists of shifting global profit into countries with a lower effective tax rate than in the corporate headquarters' home country.

It encompasses "all arrangements to reduce, eliminate, or defer a tax liability" through legal means. It takes advantage of the technicalities and incongruities between two or more legislations in the international tax system for the purpose of significantly reducing tax obligations (European Commission, 2012).

In academic literature, it is commonly referred to as an aggressive tax strategy .
From a corporate perspective, CTA supposedly benefits available corporate funds, improves shareholder value.

From a societal perspective, CTA is criticized for exploiting legal loopholes, and is often classified as a violation of fair burden-sharing, which is needed to sustain and develop public and governmental services.

01 INTRODUCTION

The OECD estimates the loss for governments on account of Base Erosion and Profit Shifting (BEPS) of up to US $650 billion each year, which is approximately the GDP of Turkey or Switzerland .

In order for the tax avoidance prevention regulations to be effective, it is necessary to be able to transparently grasp the income of multinational companies.

Each country is focusing on introducing a procedural system to increase tax transparency. Increasing transparency means that information on the entire process of generation, movement, and attribution of profits from MNE'S economic activities is transparently disclosed.

01 INTRODUCTION

With the introduction of BEPS 2.0, the global international tax environment is expected to undergo rapid changes.

The Organization for Economic Cooperation and Development(OECD) has implemented the Base Erosion and Profit Shifting(BEPS) project and the Automatic Exchange of Information system(AEOI) in order to prevent aggressive tax avoidance by multinational corporations.

The BEPS project has identified 15 actions for three key areas :
ensuring consistency in taxation,
strengthening international standards,
ensuring transparency and strengthening certainty.

In the following,
1>the system related to securing transparency in international transactions in Korea will be examined and 2>the introduction of the BEPS 2.0-related global digital tax(Pillar 1) and the global minimum tax (Pillar 2) contained in the tax law amendment released by the Korean government in July 2022.

02 Securing transparency in international transactions

(1) Automatic Exchange of Information and CbC Report

Multinational companies are carrying out business activities around the world.
But the tax returns submitted from individual countries alone have difficulty in identifying related information such as the complex transaction structure of multinational companies and transaction details with overseas affiliates.

Accordingly, in accordance with BEPS Action Plan 13 in October 2015, the OECD asked multinational corporations to submit detailed information such as national business activities, international income distribution, and tax payment status, and tried to respond internationally to multinational corporations' tax avoidance activities.

02 Securing transparency in international transactions

The Automatic Exchange of Information system regularly provides taxation information collected in one country to other countries and the OECD adopted the Common Reporting Standard(CRS).

In June 2016, Korea signed a multilateral agreement(CbC MCAA;Multilateral Competent Authoriy Agreement on the exchange of Country-by-Country Reports) for the exchange of reports country-by-country(CbC reports)

Since 2018, Korea has been exchanging CbC reports with member countries every year.
“The Law for the Coordi-nation of International Tax Affairs” revised in 2015 legally supports this.

“The Law for the Coordi-nation of International Tax Affairs” introduced regulations that impose the obligation to submit data on international transactions on certain multinational companies, which consist of a master file, a local file, and a country by country report.

02 Securing transparency in international transactions

Domestic corporations with sales exceeding 100 billion won and transactions with foreign affiliates exceeding 50 billion won
and foreign corporations with domestic operations
are obligated to submit Integrated corporate reports(master file)
and individual corporate reports(local file).

The master file should contain the organizational structure and business details of all corporations, Intangible assets, financial activities between all corporations, and financial and tax status.
In the case of the local file, reference materials such as an overview of the corporation, explanations of related parties transactions, financial statements, and contracts must be submitted.

02 Securing transparency in international transactions

Country-by-Country (CbC) Reporting is a minimum standard formulated by the OECD under Action 13 of the Base Erosion and Profit Shifting(BEPS) Package.

Under this standard, domestic UPE(ulimate parent companies) of multinational corporate groups and domestic affiliates of foreign UPE of multinational corporate groups are required to file a CbC Report in relation to an accounting period where:

- the consolidated group revenue for the preceding accounting period is at least EUR750 million (or 1trillion won)
- and the group has constituent entities or operations in two or more jurisdictions.

The CbC Report requires aggregate tax jurisdiction-wide information relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the MNE Group operates.

The Report also requires a listing of all the constituent entities for which financial information is reported, including the jurisdiction of incorporation of each of the constituent entities (if different from the tax jurisdiction of residence) and the main business activities carried out by that entity.

02 Securing transparency in international transactions

Individual countries that have received CbC reports shall exchange and utilize CbC reports in accordance with multilateral agreements, etc.
The OECD aggregates anonymized CbC reports and publishes related statistical data to provide information on international activities and tax erosion and income transfer of multinational companies.

For the first time in July 2020, statistics on CbC reports on the 2016 tax year were released, and in July 2021, statistics on CbC reports for the 2017 tax year submitted by 6,000 multinational companies from 38 countries were released.

This is of great significance as data that can compare and analyze the international activities of multinational companies. Based on this, We can analyze international activities through the decentralization of business functions of multinational corporations.
And we can analyze the proportion of corporate tax revenue of multinational corporations by country.

However, since the aggregated CbC reports are based on financial accounting data, there may be differences in actual tax returns, and there are some limitations in comparability due to differences in accounting standards by country.

02 Securing transparency in international transactions

In 2017, according to aggregated country-by-country report data, more than 40% of the headquarters of multinational corporations with sales exceeding 750 million euros (1 trillion won) in consolidated financial statements are located in the United States (1,575) and Japan (866).

There are 233 in Korea, the sixth largest among 38 countries.

Figure 1 reports total tax accrued based on CbCR statistics, as a fraction of the total national CIT revenues, taken from the OECD's Global Revenue Statistics Database.
The figure allows an examination of the relative importance of foreign and domestic MNE contributions as covered in the 2016 data.
In Korea, the share of CIT revenue from MNEs ranged 43%.
The relative importance of foreign MNE contributions ranged less than 6%.

Republic of Korea exchanges information with foreign taxation authorities through automatic exchange of financial information, automatic exchange of country-by-country reporting, tax regulations and APA voluntary information exchange.

02 Securing transparency in international transactions

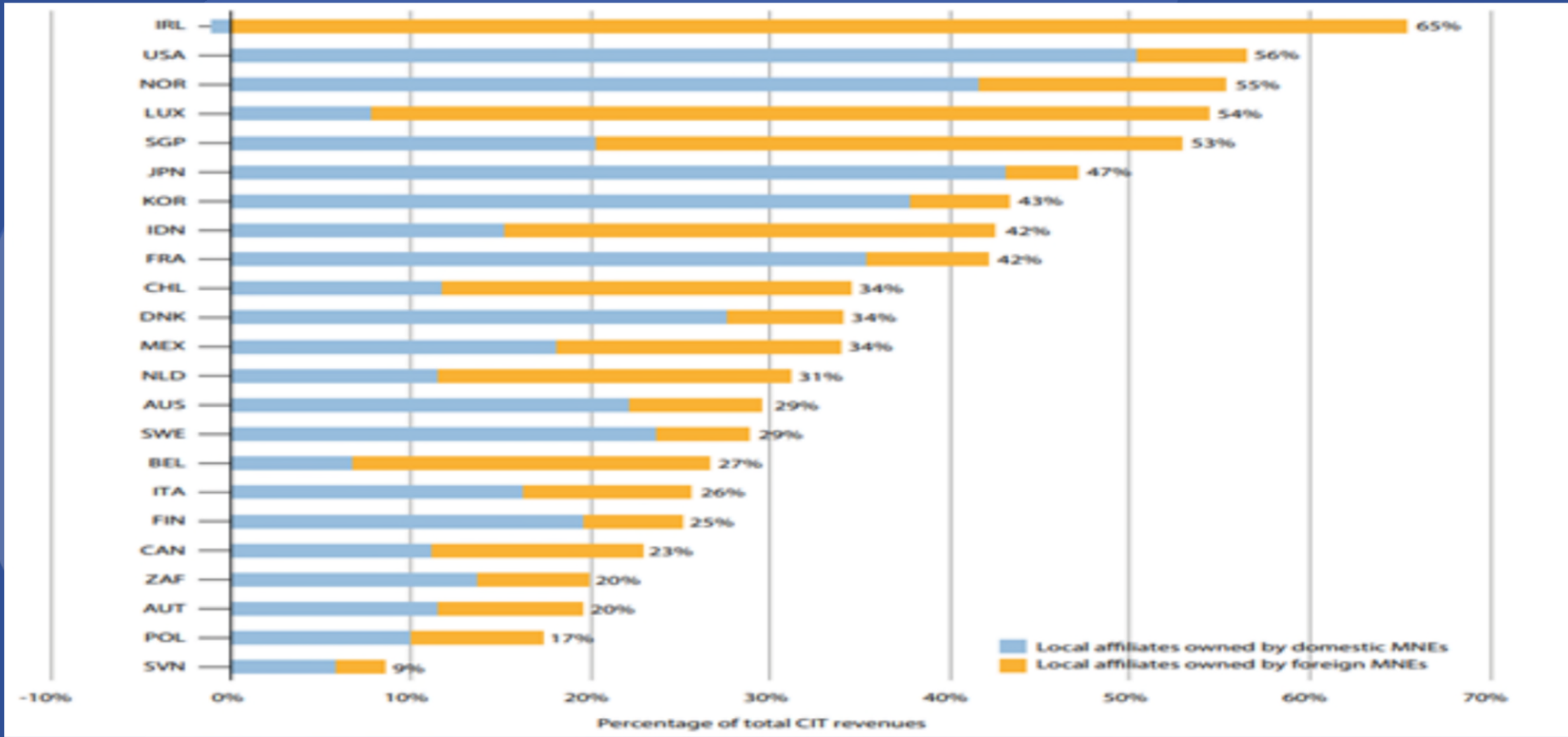

Figure1. MNEs' contribution to total CIT Revenues
Source: 2016 Anonymised and Aggregated CbCR statistics and 2016 OECD Global Revenue Statistics.

(2) The Foreign Financial Account Report System('FFARS')

In order to manage overseas source of tax revenue,
Korea has implemented the Foreign FinancialAccount Report System('FFARS')
and it is subject to fines and criminal penalties for violation of reporting duty.

The Foreign Financial Account Report System('FFARS') is a system that reports account information to the tax office when the total balance of overseas financial accounts (deposit, installment savings, securities, insurance, funds, etc.) held by residents or domestic corporations exceeds 500 million won.

This system is intended to identify offshore tax evasion sources and lay the foundation for tax source management.
In addition, this system aims to attract illegal overseas outflows of domestic capital and unjustly leaked capital within the normal taxation area.

02 Securing transparency in international transactions

(amount : trillion won)

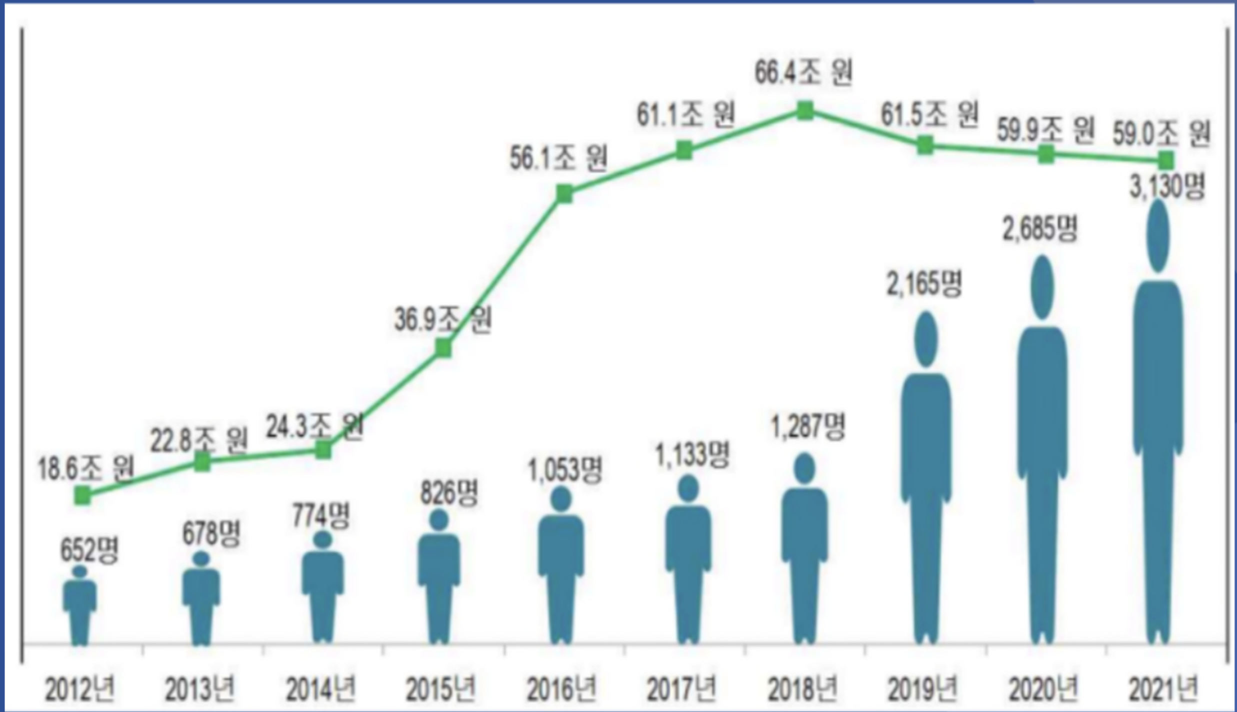

Figure2. Reported personnel and amount
sources : the National Tax Service

It was first implemented in 2011, and 3,130 people reported a total of 59.0 trillion won in 2021.

Considering international trends, Korea's ‘FFARS’ needs to be improved in order to strengthen the standard of reporting obligations, to achieve equality of fines and criminal penalties and to strengthen the duty of disclosing company's beneficial owners.

(3) Obligation to report on aggressive tax avoidance transactions(action 12)

BEPS Action 12 provides recommendations for the design of rules to require taxpayers and advisors to disclose aggressive tax planning arrangements.

It is important for each jurisdiction to obtain in a timely manner information on the tax compliance and policy risks raised by aggressive tax planning. Action 12 contains recommendations regarding the design of mandatory disclosure rules for aggressive tax planning schemes.
The Action 12 report also sets out specific recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

The OECD presented the introduction of "CbC reports" exchanged between countries as a minimum standard task. In contrast, the OECD recommended the introduction of a Mandatory Disclosure Rule as a kind of “BEST PRACTICE”.
The mandatory reporting system for tax avoidance transactions has not yet been introduced in Korea.

03 The introduction of Digital Tax and Global anti-Base Erosion (GloBE)

(1) The background

Digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being. At the same time, the breadth and speed of this change introduces challenges in many policy areas, including taxation.

Reforming the international tax system to address the tax challenges arising from the digitalisation of the economy has therefore been a priority of the international community for several years.

The Inclusive Framework of the OECD have worked on a global solution based on a two pillar approach.

03 The introduction of Digital Tax and Global anti-Base Erosion (GloBE)

Members of the Inclusive Framework agreed that any rules developed under this Pillar should not result in taxation
where there is no economic profit nor should they result in double taxation.

Inclusive Framework Members further agreed to make any rules
as simple as the tax policy context permits,
including through the exploration of simplification measures.

Pillar Two leaves jurisdictions free to determine their own tax system,
including whether they have a corporate income tax
and where they set their tax rates, but also considers the right of other jurisdictions
to apply the rules contained in the report.

2. Global digital Tax and Global anti-Base Erosion (GloBE)

Pillar 1 is applied to global companies with consolidated sales exceeding 20 billion euros (about 27 trillion won) and a profit margin exceeding 10%.
The key content is to allocate taxation rights to the market's location even if there are no PE assuming that a quarter of the global excess profits of companies are created by the market's contribution.

Pillar One focuses on the allocation of taxing rights, and sought to undertake a coherent and concurrent review of the profit allocation and nexus rules.

In Korea, among domestic companies, Samsung Electronics and SK Hynix are expected to be subject to taxation.

Samsung Electronics has sales and production bases in about 200 places in the U.S., Europe, and China, and SK Hynix has sales and production bases in about 30 places in China and Europe.

03 The introduction of Digital Tax and Global anti-Base Erosion (GloBE)

When the digital tax is introduced, both companies will have to pay some of the corporate taxes paid in Korea to overseas countries where sales and profits have occurred.
The corporate tax paid by Samsung Electronics last year totaled $3.7 billion and SK Hynix $1.1 billion.

Even if the digital tax is introduced, the industry expects to affect Korea's national tax revenue as it pays some of the corporate tax paid in Korea to overseas countries,
but the impact on companies will not be significant.
However, there is a possibility that the total amount of tax to be paid may increase or decrease depending on the difference between the tax rate to be paid to the country and the domestic corporate tax rate.

03 The introduction of Digital Tax and Global anti-Base Erosion (GloBE)

Pillar 2 is applied to MNEs with consolidated sales of 750 million euros (about 1 trillion won), and the main content is to require the parent company to pay additional taxes to its own tax offices if the effective tax rate falls short of 15 percent.

Korea has finalized and announced the "2022 tax reform plan," which includes the global minimum tax.

The "global minimum tax system" included in the revision was agreed by the OECD and the G20 comprehensive implementation system (IF) to prevent competitive tax cuts in countries around the world.

Sales of digital companies such as Google, Amazon, and Netflix occur in several countries. But they have paid taxes only at the location of the PE. The "global minimum tax system" is also called "digital taxes" because it is introduced to solve the "tax avoidance" problem of paying taxes only to countries with servers (fixed workplaces). The system will take effect in 2024.

The target is a group of multinational companies with sales of more than 750 million euros (about 1 trillion won) in consolidated financial statements for more than two of the previous four business years. The government predicted that 245 out of the ultimate parent companies in Korea (company that submits reports by country in 2019) will be subject to application.

03 The introduction of Digital Tax and Global anti-Base Erosion (GloBE)

The basic method of operating the system is to grant additional taxation rights to other countries when an effective tax rate lower than the minimum tax rate of 15% is applied to the income of multinational companies. This is called the 'Income Inclusion rule'.

In cases where the ultimate parent company is taxed at a low rate or the country where the parent company is located does not introduce the above ‘Income Inclusion rule’, overseas subsidiaries must pay additional taxes to the tax authorities where they are located(UnderTaxed Payment Rule). In order to secure the effectiveness of the obligation to report information related to the global minimum tax, the government will be subject to fines of up to 100 million won.

The introduction of a "digital tax" in which multinational corporations pay taxes to countries where actual sales occurred will significantly increase the corporate tax that Google and Apple will pay in Korea. According to the study (Kim Wan-yong, 2022), among the five FAANG (Facebook, Amazon, Apple, Netflix, and Google), the corporate tax of Google and Apple is estimated to increase by a total of 223 billion won, 45.2 billion won and 177.8 billion won.

03 The introduction of Digital Tax and Global anti-Base Erosion (GloBE)

The tax avoidance of multinational corporations should be criticized as a violation of fair burden-sharing.

This is also a oblivion to corporate social responsibility.

The success of the introduction of Beps 2.0 in the international tax system depends on the system to security tax transparency.

International cooperation and interest from tax advisers are required
to avoid double non-taxation and to security tax transparency.

Thank you

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