

# NEWSLETTER

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Tax Group

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## Korea-Taiwan Double Taxation Avoidance Arrangement Comes into Force

The Implementation Act of the Arrangement between Korea and Taiwan for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income (the **Korea-Taiwan Tax Arrangement**) officially took effect on December 26, 2023, following endorsement by the National Assembly. For residents of the Republic of Korea, the benefits the Arrangement apply, in respect of taxes subject to withholding, on or after January 1, 2024, and in respect of other taxes, for tax years commencing on or after January 1, 2024. The key highlights of the Arrangement are as follows:

### 1. The Background of Korea-Taiwan Tax Arrangement

Despite Taiwan's status as a significant economic partner in which over 100 Korean companies are present, the absence of a Double Taxation Avoidance Agreement (Tax Treaty) has been posing challenges for Korean companies and residents of high tax burden and instances of double taxation therefrom in the course of trade, investment, and interpersonal exchanges with Taiwan. In an effort to address this concern, both sides signed the 'Arrangement between Korea and Taiwan for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income' on November 17, 2021.

Although the Korea-Taiwan Tax Arrangement holds a formal status below the level of a Tax Treaty, its practical effects are equivalent to those of a treaty. This parity arises from the fact that the implementing legislation was passed by the National Assembly in the last December, ensuring the domestic implementation of the Arrangement.

### 2. Key Takeaways for Allocation of Taxing Rights

The provisions governing the allocation of taxing rights under the Korea-Taiwan Tax Arrangement are structured on the basis of the OECD Model Treaty, with some provisions reflecting certain elements of the UN Model Treaty. A concise summary of some key provisions is provided as below.

| Category                         | Key provisions   |
|----------------------------------|--|
| Permanent Establishment(PE)      | <ul style="list-style-type: none"> <li>■ A fixed place of business, such as an office, branch, or factory, where an enterprise carries on its business wholly or partially</li> <li>■ For a construction site, a PE threshold period of six months applies, encompassing activities performed by a related parties</li> <li>■ A PE exists if services (performance of personal services) are provided for a duration exceeding 183 days within a 12-month period</li> <li>■ The habitual activities conducted by a contracting agent are deemed as a PE</li> </ul> |
| Business Profits                 | <ul style="list-style-type: none"> <li>■ Business profits of an enterprise shall be taxable only when the enterprise carries on business in the source country through a PE located therein</li> <li>■ Transactions between permanent establishments and head offices are subject to arm's length principle</li> </ul>   |
| Dividends · Interest · Royalties | <ul style="list-style-type: none"> <li>■ Withholding tax rates will be a uniform rate of 10 percent</li> </ul>   |
| International Shipping Income    | <ul style="list-style-type: none"> <li>■ Profits from international traffic carried on by an enterprise shall be taxable only in the residence country</li> </ul>  |
| Capital Gains                    | <ul style="list-style-type: none"> <li>■ As a general principle, capital gains shall be taxable in the residence country</li> <li>■ However, in certain cases, such as real estate, movable property used for business purposes of a permanent establishment, shares whose 50% plus value consist of real estate (real estate shares), and shares of a shareholder who directly or indirectly holds 25% or more of the interest of the enterprise, capital gains from their alienation shall be taxable in the country where the assets are located</li> </ul>     |
| Pensions                         | <ul style="list-style-type: none"> <li>■ Shall be taxable in both countries of residence and payment</li> </ul>  |
| Anti-Tax Avoidance               | <ul style="list-style-type: none"> <li>■ Transactions where the facts and circumstances suggest that the principal purpose of the transaction is to exploit the benefits provided by the Agreement will not qualify for the entitlement of this Arrangement</li> <li>■ Anti-Tax Avoidance provisions under domestic law are also applicable irrespective of the Arrangement</li> </ul>   |

### 3. Cooperation of Tax Administration and the Elimination of Double Taxation

The Korea-Taiwan Tax Arrangement, like other tax treaties, incorporates provisions safeguarding taxpayers and fostering administrative cooperation among tax authorities. These provisions encompass the Nondiscrimination in taxation on residents, permanent establishments, expense deductions, and capital ownership under certain conditions. The Arrangement further establishes a mutual agreement procedure designed to afford relief to taxpayers facing tax measures inconsistent with the agreement, including transfer pricing assessments. Additionally, it facilitates the

exchange of information in connection with the enforcement of the Arrangement or domestic tax law.

With respect to the elimination of double taxation, Korean residents may offset the amount of tax paid or payable in Taiwan on their foreign-sourced income against their domestic corporate income tax or individual income tax (the **direct foreign tax credit**). Furthermore, if there is a dividend income from a Taiwan-based company in which the enterprise holds at least 25% interest, the credit for the enterprise shall take into account the Taiwan tax payable by the company in respect of the profits out of which such dividend is paid (the **indirect foreign tax credit**). It is important to note that in practice, the requirements for the indirect foreign tax credit under the Corporate Income Tax Law will likely apply which has a more favorable threshold of 10% shareholding (Article 57(4) of the Corporate Income Tax Law).

#### 4. Implications of Korea-Taiwan Tax Arrangement

As the implementation of the Korea-Taiwan Tax Arrangement starts in 2024, Korean companies operating in Taiwan will be able to compete on a level playing field with counterparts in Japan, Australia, Germany and other nations that have previously entered into Tax Arrangements with Taiwan while this Arrangement alleviates the tax burden and related double taxation in Taiwan for the Korean companies.

Specifically, in cases where a Taiwanese subsidiary of a Korean headquarters faces taxation in Taiwan due to transfer pricing, Korean companies will have the means to address the double taxation concern through the mutual agreement procedure. Furthermore, Korean companies operating in Taiwan will have the opportunity to leverage bilateral Advanced Pricing Agreement (Article 14 of the International Tax Coordination Law) with the tax authorities of both countries to mitigate transfer pricing risks that may potentially arise in both Korea and Taiwan.

The Tax Group at Lee & Ko has extensive experience and unparalleled expertise in advising on the application of tax treaties, as well as facilitating the process of applying for mutual agreement procedures and advanced pricing agreements with tax authorities across different jurisdictions. If you require assistance with any international tax matters, including those related to the Korea-Taiwan Tax Arrangement, please feel free to reach out to the Lee & Ko Tax Group.



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