

Permanent Establishment

1. Definition of Permanent Establishment

A permanent establishment is a domestic fixed place of business where a foreign company conducts its entire or partial business. In tax treaty, the terminology 'Permanent Establishment' is generalized, however, in the corporate taxation, it is expressed as 'domestic place of business'. Since there are no differences in the concepts, both of them are used concurrently. In principle, the permanent establishment should meet all of the following three conditions:

1) The existence of the business location

The business location means building, equipment, or facilities etc. in general, however, some fixed area for the foreign company's use may even be considered to be a business place.

2) Fixedness

Fixedness means the continuance of the term. Therefore, not only with the case with a fixed location, but also with the case where the business is conducted while the location is being changed (example: river survey), it satisfies the requirement for the fixedness, if the business is continued for a certain period of time.

3) Performing business activities

A major business of the company should be performed at the permanent establishment. The business activities do not have to be performed by human, but they can also be performed by machines (example: vending machine). However, the preliminary and ancillary activities only for the headquarters (example: advertisements or purchases for the headquarters) are not considered to be business activities meeting the requirements for the permanent establishment. Even in this situation, any advertisements or purchases made for other company rather than for the headquarters are considered to be business activities.

2. Examples of Permanent Establishment

As long as there are no special circumstances, the following places are considered to be a permanent establishment, in principle:

- ① Branches, offices or sales office
- ② Shops, other fixed sales place
- ③ Places of work, factories or warehouses

- ④ A place of building construction or site of construction, assembly, installation construction, or place where management activities for the related works are performed, which has existed for more than 6 months.
- ⑤ Any of the following places where employees provide services:
 - (a) A place where services are provided for at least six months in total during a 12-month period in which such services continue to be provided;
 - (b) A place where services are provided for not more than six months in total during a 12-month period in which such services continue to be provided, and similar services are continuously and repeatedly provided for at least two years;
- ⑥ Mines, quarry or a place of exploration or collection for natural resources on the ocean floor

Where a foreign corporation without any fixed places operates the business in Korea through a person who is authorized to conclude contracts on its behalf and repeatedly exercise such authority or an equivalent person prescribed by Presidential Decree, the location of the person's place of business (where he/she does not have any place of business, it shall be his/her address, and where he/she does not have any address, it shall be the location of his/her residence) shall be deemed the domestic place of business of the foreign corporation.

However, the following places where the activities in the fixed establishment are not essential and pertinent activities of the foreign corporation (Headquarters), but rather preliminary and ancillary, are not considered to be permanent establishment.

- ① A fixed place used only for the purchases of the assets
- ② A fixed place used for the storage or preservation of assets which are not intended for sales
- ③ A place used for the advertisement, promotion, collection and supply of information, and market research
- ④ A place used by a foreign corporation only for the purpose of processing its own assets by other person.

3. Taxation issue pertaining to the permanent establishment

Since there are such differences in the taxation of a foreign corporation depending on whether the foreign corporation has domestic permanent establishment or not, it is imperative to judge whether the branch, office, sales office or construction site is considered to be a permanent establishment.

1) Determining whether the business income is taxable

In the event that a tax treaty is established, the business income of a foreign corporation without a permanent establishment (domestic establishment) is not taxable. Otherwise, as for the business income of a foreign corporation, an income tax will be withheld at a rate of 2%.

2) Determining the taxation method

A foreign corporation with permanent establishment should file and pay for the corporate tax for the sum of domestic incomes vested in the permanent establishment. However, the duty of tax payment for a domestic source income of a foreign corporation without a permanent establishment is fulfilled only by tax withholding of the person who pays the income.

3) Determining whether the reduced tax rate should be applied for an interest, dividends, and royalties

Under tax treaty, interests, dividends, and royalties by a foreign corporation are subject to the limited tax rate (low rate of 5% - 15%). However, if the permanent establishment is involved in the occurrences of such investment income, the reduced tax rate is not applied, and they must be filed and paid at the permanent establishment after they are totaled.

4. Deemed permanent establishment

(1) Dependent Agent

Even if the foreign corporation does not have a permanent establishment such as a branch or office, in the event it performs business activities using a person who possesses a right to establish contracts for the foreign corporation domestically, or equivalent person (hereinafter called 'dependent agent'), it is deemed to have a domestic permanent establishment. In short, a dependent agent can be defined as an agent when the foreign corporation performs business through the agent so that it benefits the equal economic effects as if it has a permanent establishment (fixed place) in general term.

[Definition of dependent agent]

A. Among the requirements for the agent for the contract establishment, 'exercises the right to execute contract' means as follows:

- ① A person who has a right to execute contracts for the business on behalf of the foreign corporation¹, and can exercise the rights anytime. (Agent for the contract establishment)

¹ As described above, a foreign corporation includes related party with the foreign corporation.

- ② A person who keeps the assets of a foreign corporation on a regular basis, and delivers or hands over (Agent for retention of assets) such customarily.
- ③ A person who performs important tasks regarding the business such as contract establishment mainly only for the specific foreign corporation, as a broker, commissioned salesperson, or other person in independent position (Agent for receiving order)
- ④ A person who collects insurance premiums or acquires the insurances for the domestic insurable for the foreign corporation which performs insurance business (excluding reinsurance business)

B. Other terminologies

① What is a contract?

A contract should be pertinent to mainly business activities. Therefore, the contracts for employment or for the cases that exercise the right to establish a building lease do not apply to the dependent agent. In other words, even if the right to execute contracts regarding the ancillary activities are exercised all the time, they are not considered as permanent establishment.

② What does it mean by 'all the time'?

Because the requirements for the fixedness of permanent establishment means the continuance of term, the rights for the foreign corporation of the dependent agent should be exercised repeatedly in order to satisfy the requirement for the permanent establishment.

③ What does it mean by 'exercise'?

Because an exercise of right to execute contracts does not require the agent to sign the name on the contract, in the event that the terms and conditions of the contract are practically agreed, it is considered that the right to execute contracts is exercised, regardless of the existence of a signature.

[Other examples]

A. An airline company's mutual representation

In the event that an airline company that is engaged in the domestic transportation business establishes a contract for transportation on behalf of another airline company, as a mutual agency for another airline company according to the international flight agreements, for instance, by joining International Aviation Transportation Association (IATA), it is not considered to be a dependent agent, as it is a case that the task was performed for the foreign corporation according to the inevitable needs due to the nature of the business, while doing the same or similar business as with the foreign corporation.

B. A dependent agent under tax treaty

It should be noted that due to some variance of tax treaties ratified by Korea and other countries, the scope and the definition of the dependent agent that is considered as permanent establishment may vary somewhat. There are treaties which define the collection of insurance premiums or insurance brokerage agent (Belgium, Indonesia, etc.), treaties that define only the agent who establish contracts, (New Zealand, Malaysia, etc.), treaties that define the agent who establish contracts and the agents for the retention of resources (USA, the United Kingdom, Germany, etc), treaties that define all agents who establish contracts, agent for the retention of assets, and agent for order basis (Thailand).

(2) Independent Agent

Tax treaty defines some exceptions to the rule for the permanent establishment, even if it fulfills the requirement for the permanent establishment (exercise of the right to execute contracts, retention of assets, and delivery), and this is called an independent agent. The cases where the permanent establishment is deemed not to exist even if the task performed are of those dependent agents are as follows:

- ① The agent should be independent of the foreign corporations
- ② The cases where the activities for the foreign corporations will be performed in the typical business process by the agent

[Main concept of independent agent]

A. What is independence?

- ① The degree of duty

The business activities of an agent for a foreign corporation should not take detailed instructions or be subject to overall control by the foreign corporation.

- ② Risk sharing of business

The agent should bear the business risk. In other words, only when the agent performs the business activities under his or her own responsibility, it may consider to be independent.

- ③ Multiplicity of client companies

It is highly probable to be dependent on the foreign corporation in case when the agent performs the business activities entirely or almost entirely for one foreign corporation. Therefore, in case the contracts are executed for the unspecified multiple clients, the independence can be recognized.

B. Requirements for typical task

Agent's activities for the foreign corporation should be within the scope of his or her typical business activities.

[Distinguishing a dependent agent and independent agent]

Item	Dependent agent	Independent agent
1. A relationship between a foreign corporation and an agent	The agent is in the position where he or she legally or economically belongs to the foreign corporation.	The agent is in the position where he or she legally or economically independent from the foreign corporation
- Foreign corporation's management of agent's tasks	While performing the business activities, the agent receives the detailed instructions and overall controls from the foreign corporation.	While performing the business activities, the agent does not receive the detailed instructions and overall controls from the foreign corporation.
- Risk sharing of business	The foreign corporation assumes the business risk.	The agent assumes the business risk that arises from his or her own business activities.
- The number of the foreign corporations	Performs agency activities entirely or almost entirely only for a specific foreign corporation.	Performs for unspecified multiple foreign corporations
2. The nature of representation activities	Even if the status of agent is an independent agent, in the event that his or her representation activities are outside of its typical business activities, the agent is considered to be a dependent agent.	An agent with the independent status should perform representation activities within the scope of his typical business process.

(Note: Even if the independent agent performs the same business activities as the dependent agent, because of the status of independence, it is not considered to be a permanent establishment. Therefore, because of this concept, all the above requirements must be satisfied.)