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Tax treaties are intended to resolve competing national claims to the same tax revenue. When the parties to the treaty dispute the meaning of the treaty or apply the treaty in different ways, the intent of the treaty to resolve competing tax claims can be frustrated. Therefore, whether a treaty's central purpose will be carried out very much depends on the effectiveness of a method for resolving these disputes and differences.

Fortunately, tax treaties contain a strong tool for resolving case-specific disputes as well as more generally applicable disputes over interpretation: the mutual agreement process (MAP). The strength of this tool, however, and therefore a competent authority's effectiveness, depends crucially on (1) administrative practices that support rather than hinder the MAP, including a willingness on the part of the competent authority to exercise fully his authority to resolve cases; (2) clear and specific principles for resolving cases; and (3) an absence of domestic laws that have the effect of overriding treaties. Unless these factors are present, there is potential for results to be so unsatisfactory that the intent of the treaty is not carried out. This article discusses one such situation.

In our experience, the U.S. competent authority and the competent authorities of several other nations discharge their responsibility to resolve competing national claims to the same tax revenue in exemplary fashion. They work extremely hard to pursue a correct and fair outcome, and in the great majority of cases they succeed. Although the process often takes time,[1] these competent authorities set a high standard for how disputes should be resolved.

But some countries' competent authorities, and some specific types of cases dealt with by those competent authorities, have proven to be particularly difficult to resolve, for reasons that are unnecessary at best. One example is the determination of the appropriate source of royalties under the South Korea-U.S. tax treaty.

Many treaties and the OECD Model Tax Convention on Income and on Capital have addressed problems with identifying the source of royalty income by eliminating entirely the right of the source country to withhold on royalties. (Similarly, when services are involved, the OECD model convention has limited source country rights to tax service fees or wages to situations in which the service provider has a permanent establishment in the source jurisdiction.) The South Korean treaty, however, allows the imposition of a withholding tax on royalties. Although the treaty permits withholding on royalties, the treaty negotiators determined that a treaty party should do so only when the underlying intellectual property is ''used'' in that jurisdiction. It had long been well established under South Korean law that the place of patent registration

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[1] For example, the combined (U.S.- and foreign-initiated) processing time for allocation, non-allocation, permanent establishment, and limitation on benefits cases closed with the U.S. competent authority by year was 840 days in 2011, 868 days in 2010, 772 days in 2009, and 649 days in 2008.

should control the place-of-use determination. Determining ''use'' based on place of patent registration is, as explained in greater detail below, a governing principle of economic nexus that makes sense for purposes of determining the appropriate taxing jurisdiction of patent royalties. The Supreme Court of South Korea itself has on two occasions concluded that the term ''use,'' particularly in light of the treaty, is based on this mutually understood, economically sound principle.

However, in 2008 South Korea unilaterally disregarded this principle by enacting a law that would permit South Korean sourcing of a royalty payment made by a South Korean company to a U.S. patent holder for the right to use the patent even when the patent had no legal protection in South Korea but did (by virtue of U.S. registration) in the United States.

Importantly, the South Korean competent authority has an effective tool at its disposal that if used would prevent this change from having the effect of a treaty override. Unfortunately, the South Korean competent authority has, for reasons that are unclear, chosen not to use that tool.

I. The Treaty Negotiators' Intent

Contrary to most other tax treaties signed by South Korea,[2] the negotiators of the South Korea-U.S. treaty determined that royalties should be sourced exclusively based on place of use. Article 14(4) of the treaty defines royalties as including ''payment of any kind made as consideration for the use of, or the right to use'' specified intellectual property. The source of royalty payments is determined under article 6 of the treaty, which states that ''royalties . . . for the use of, or the right to use, property . . . shall be treated as income from sources within one of the Contracting States only if paid for the use of, or the right to use, such property within that Contracting State.'' The treaty does not further define the term ''use.'' In general, undefined terms in the treaty have the meaning ascribed to the term under the law of the country whose tax is at issue (in this case, South Korea) *unless the context otherwise requires*.[3]

II. Place of Registration

A. Background. The basic function and purpose of patent laws — to protect and incentivize innovation in the domestic sphere by way of a requirement to publicly register patents — is incorporated in the domestic law of both treaty parties. That is, under both U.S. and South Korean law, patented intellectual property is public, not secret information, and rights to use patented intellectual property are limited only by local patent law. Unsurprisingly then, it had long been well established under South Korean law that the place of patent registration controls the place-of-use determination.

The Korean Intellectual Property Office succinctly summarizes the purpose of the South Korean patent system as follows:

> The purpose of the patent system is, to accelerate the development of technology through the protection, encouragement, promotion, and utilization of inventions, and thereby contribute to the development of industry. The laying open of inventions leads to the accumulation and utilization of technology and the advancement of industry. Granting exclusive rights for the commercial usage of a patented invention promotes commercialization, encourages the development of inventions, and leads to the advancement of industry.[4]

U.S. patent law is similar. A patent issued in the United States cannot be used in the United States over the patent holder's objection, and a patent not issued in the United States (but issued elsewhere) may be used in the United States over the patent holder's objection.

If patented intellectual property is used in a jurisdiction where a patent is not registered — for example, by employing foreign-patented technology in a domestic manufacturing process — it should not follow that the patent rights are ''used'' in that jurisdiction. Payment for use of a patent is necessarily driven by registration; the use in this example is completely unrestricted, lacking the incentive-driven exclusivity provided by patent registration. That use therefore should not constitute ''use'' as envisioned by the treaty negotiators. Determining ''use'' based on the place of patent registration is a governing principle that makes sense for purposes of determining the appropriate taxing jurisdiction of patent royalties — a principle based on concepts of economic nexus at the heart of the treaty parties' patent laws.

B. The South Korean Supreme Court's endorsement of this well-established place-of-use definition in light of the treaty. Before 1988, the Korean Corporate Income Tax Law (CITL) provided that patent royalties were to be sourced based on the place of intellectual property use. In 1988 South Korea amended the CITL to provide that Korean sourcing of patent royalties is appropriate not only if the patent is used in South Korea, but also if the patent royalty is paid there.[5] On

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[2]*See infra* text accompanying note 31.

[3]*See* article 2(2) of the South Korea-U.S. treaty.

[4]Korean Intellectual Property Office, ''Overview of the Patent System in Korea,'' *available at* http://www.kipo.go.kr/.

[5]*See* Korean Ministry of Strategy and Finance (MOSF), *Korean Taxation* (2010) (summarizing that ''for royalties to be treated as having a Korean source under the Korean tax law, properties, information and rights in relation to which royalties are paid have to be used within Korea or such royalties have to be paid in

(Footnote continued on next page.)

two occasions after this modification of South Korean law, the Supreme Court of South Korea held, particularly in light of the treaty, that the place of use of patented intellectual property depends on the place of patent registration.

In 1992 the Supreme Court of South Korea held that under the CITL a patent is effective only in the country where registered and that payments for the use or infringement in South Korea of a patent not registered there do not constitute Korean-source income.[6] The Supreme Court stated:

> In a case where a patented product is manufactured in Korea where the patent of a foreign company is not registered and exported or sold to a foreign country where the patent is registered, the use or infringement of the patent right is a matter only related to the use or infringement of the patent right which the foreign company has with respect to the import or sale of the said patented product in the foreign country where the patent is effective, but not related to the use itself of such patented product within Korea.[7]

The Supreme Court, with reference to the treaty, then confirmed:

> Both ''the income received as consideration for the domestic use of a patent right,'' which is stipulated as a Korean source income in Article 55 (1)-9-(a) of the Corporate Income Tax Law (the ''CITL''), and ''royalties described in paragraph (4) of Article 14 for the use of patent right or other like property shall be treated as income from sources within one of the Contracting States only if paid for the use of, or the right to use, such property within that Contracting State'' as provided in Article 6 of the US-Korea Tax Treaty (the ''Treaty'') should be interpreted as indicating income received as consideration for the use of the patent right when a foreign company (such as a US company) registered a patent in Korea and has a patent right within Korea.[8]

In 2007 the South Korean Supreme Court again addressed the meaning of patent ''use'' under the CITL and articles 6 and 14 of the treaty. It unanimously held that if a foreign patent holder does not register a patent in South Korea and the Korean manufactured products incorporating the foreign patented technology are sold to end-users in the United States, damages paid for lost royalties and additional consideration are for the infringement and use of the patent right in the United States.[9] The South Korean Supreme Court, with reference to its 1992 decision, summarized the nature of patent rights and sourcing of patent royalties under the CITL and treaty as follows:

> Given the territorial limitations of patent rights, exclusive rights of the patent owner to manufacture, use, transfer, rent, utilize, exhibit, etc. is effective only in the territory of the country where the patent is registered. As such, the meaning of Article 93, Item 9(a) of the then CITL, which lists royalties paid as consideration for the use of patent rights in Korea as Korean source income and Article 6 of the Treaty, which stipulates that ''royalties described in paragraph (4) of Article 14 for the use of patent right or other like property shall be treated as income from sources within one of the Contracting States only if paid for the use of, or the right to use, such property within that Contracting State,'' should be interpreted as income received as consideration for the use of the patent right when a foreign company or U.S. company registered a patent in Korea and has a patent right within Korea.[10]

Accordingly, the South Korean Supreme Court affirmed the original verdict issued by the Seoul High Court in 2005, that ''the royalties and infringement consideration paid by the Plaintiff to I.P. Global through DECA in relation to a case where I.P. Global, the patent rights owner, did not register the patent rights in Korea is consideration for the infringement and use of the patent rights in the U.S., not for use in Korea of the patent rights or technologies covered under the patent by the Plaintiff.''[11]

These South Korean Supreme Court cases appear to have been correctly decided in accordance with the mutually understood,[12] economically sound principle that

Korea. Previously, only those royalties paid for the use of properties within Korea were deemed as having a Korean source. However, since the amendment of the relevant tax law in 1988, payments made within Korea have been regarded as domestic-source income even if properties concerned are used abroad, unless tax treaties specify the income concerned should be deemed to have a source in the place where properties concerned are used'').

[6]*See* 1991 NU 6887 (May 12, 1992).

[7]*Id*. (unofficial condensed English translation).

[8]*Id*.

[9]*See* 2005 Du 8641 (Sept. 7, 2007).

[10]*Id*. (unofficial condensed English translation).

[11]*Id*.

[12]While the focus of this article is on South Korean law, U.S. law similarly defines intellectual property use with reference to the place of intellectual property protection. *See* Rev. Rul. 68-443, 1968-2 C.B. 304 (place of use is the place where product consumption and intellectual property protection merged); Rev. Rul. 64-206, 1964-2 C.B. 591 (when a Swiss resident holding a U.S. patent was awarded damages and interest for infringement of the U.S. patent, the IRS treated the damages payment as U.S.-source income, exempt from U.S. income tax under the relevant treaty); Rev. Rul. 72-232, 1972-1 C.B. 276 (royalties from book sales are sourced by reference to the place where the end-user and intellectual property protection merged, not the place where the books were manufactured); FSA 200139022, *Doc 2001-24962*,

(Footnote continued on next page.)

prevents the sourcing of patent royalties based on use to a jurisdiction in which the underlying patent is not registered.[13]

III. Effective Treaty Override?

In 2008, however, South Korea unilaterally abandoned this mutually understood, economically sound principle by amending the CITL. On December 26, 2008, citing (1) Supreme Court cases denying the South Korean tax authorities the ability to tax payments for the use of patent rights that are not registered in South Korea[14]; and (2) commentary to article 12 of the OECD model convention, South Korea amended the CITL to provide that income from a patent right registered only outside South Korea, but used in connection with manufacturing or sales there, is assumed to be used in South Korea irrespective of the place of patent registration.[15] The CITL amendment appears to lack a sound legal basis and has the potential to effectively override the South Korea-U.S. treaty.

A. The amended CITL's potential to effectively override the treaty. Under the amended CITL, any payment made by a South Korean company to a U.S. patent holder for the right to use the patent in the United States can be deemed, at least in part, to be income from South Korean sources as long as the South Korean company in some way used the underlying intellectual property in South Korea. This is so even though the patent is not Korean-registered, such that the South Korean company lacks incentive to pay the U.S. patent holder for that use based on the exclusivity provided only through patent registration. For example, assume the following: (1) a U.S. resident holds a patent registered only in the United States; (2) a South Korean resident infringes that patent by employing the patented technology in a manufacturing process in South Korea and then selling the finished products incorporating the patented technology back into the United States; and (3) the South Korean resident is required to pay damages for that infringement. Under the intended treaty conception of ''use,'' the payment for that infringement is clearly U.S.-source income, as recognized by the South Korean Supreme Court.[16] However, under the amended CITL, because the South Korean resident employed the patented U.S. technology in the manufacturing process in South Korea, the payment for patent infringement would be sourced at least in part to South Korea irrespective of the fact that (i) the patent was registered in the United States and not South Korea and (ii) the infringing sales occurred in the United States.

B. Deficiencies in relying on the amended CITL. The CITL amendment cites specifically South Korean Supreme Court cases based on which the Korean tax authorities would be unable to tax payments for the use of patent rights that are not registered in Korea as a reason for enacting the amendment. As discussed, the South Korean Supreme Court had held that patent royalties could not be sourced to South Korea under the CITL or treaty if the underlying patent was not registered in South Korea. One can presume the South Korean Supreme Court cases discussed above, which involved U.S. taxpayers and application of the treaty, were a major catalyst, or *the* major catalyst for the CITL amendment. Those cases were decided based on the mutually understood, economically sound principle preventing the sourcing of patent royalties to a jurisdiction in which the underlying patent is not registered. That principle remains intact.

South Korea additionally cited commentary to article 12 (royalties) of the OECD model convention as a basis for amending the CITL. It is unclear on what basis South Korea understood this commentary to suggest such an amendment to the CITL was in order. Paragraph 8 of that commentary provides:

> Paragraph 2 [of article 12] contains a definition of the term ''royalties.'' These relate, in general, to rights or property constituting the different forms of literary or artistic property, the elements of intellectual property specified in the text and information concerning industrial, commercial or scientific experience. The definition applies to payments for the use of, or the entitlement to use, rights of the kind mentioned, *whether or not they have been, or are required to be, registered in a public register*. The definition covers both payments made under a license and compensation which a

2001 WTD 191-24 (lump sum payment under settlement agreement was properly treated as U.S.-source income because ''the settlement agreement . . . settles claims of infringement of U.S.-registered patents, subject to legal protection only in the United States'').

[13]The MOSF, the arm of the South Korean competent authority charged with interpretation of tax treaties (*see* OECD, ''Korea Dispute Resolution Country Profile'' (last updated Mar. 31, 2010)), also accepts that the 1988 CITL amendment does not override South Korean tax treaties under which the sourcing of patent royalties continues to be based exclusively on place of use. In *Korean Taxation*, the MOSF goes on to state that ''royalties may be treated as having a source either in a state in which consideration concerned is paid or a state in which properties or information concerned is used. *While most tax treaties Korea has concluded stipulate that royalties are deemed to have a source in the payer's state of residence, a state in which properties concerned are used is regarded as a state of source under*'' the treaty with the U.S. MOSF, *supra* note 5 (emphasis added).

[14]For examples of these cases, see, e.g., 1991 NU 6887; 2005 Du 8641.

[15]*See* CITL article 93(9). The amendment is effective for income arising on or after January 1, 2009. The relevant law has been amended on other occasions. Those amendments are not discussed.

[16]*See* 1991 NU 6887; 2005 Du 8641.

person would be obliged to pay for fraudulently copying or infringing the patent.[17]

This paragraph of the OECD commentary addresses the scope of the royalty definition; it is meant to provide an expansive and inclusive definition for the term ''royalties,'' not to undermine the inherently territorial nature of patent rights.[18] The parallel provision under the South Korea-U.S. treaty is found at article 14(4). Neither addresses the definition of patent use or the sourcing of patent royalties. In no way does OECD commentary on the definition of royalties indicate that royalty payments should be sourced without reference to the place of patent registration.

Moreover, a recent South Korean district court decision, rendered after the relevant CITL amendment, explicitly holds that despite the 2008 amendment to the CITL, royalty payments under the treaty continue to be sourced based on the place of patent registration.[19] The South Korean district court confirmed that under South Korean law, a tax treaty overrides domestic tax laws and that the determination of Korean-source income of a U.S. company should therefore be made pursuant to the treaty.[20] In so confirming, the district court stated:

> Under Article 6(3) and Article 14(4) of the Treaty, in case a U.S. company registered a patent in Korea and owns a patent right in Korea, payment made as consideration for the use of the patent right shall be treated as Korea source income, and any payment made to a U.S. company as consideration for the use of patents not registered in Korea shall not be treated as Korea source income. Therefore, the income, which falls under the latter case, cannot be treated as Korean source income despite Article 93 of the CITL, and thus, corporate income tax should not be assessed on the income in question.[21]

While this South Korean district court case has been appealed and the ultimate result is therefore unknown, the court's decision clearly suggests that the 2008 CITL amendment lacks a sound legal footing and has no effect in light of the treaty.

IV. Preventing Effective Treaty Override

A domestic legislative action such as the 2008 CITL amendment that modifies the definition of a term having a mutually agreed meaning before the action could undermine the ability of the competent authority to fulfill the purpose of the MAP and amount to an effective treaty override, at least in some circumstances.[22] However, both the treaty and the OECD model convention provide an effective tool that permits a competent authority to discharge his responsibilities and prevent such an effective treaty override.

The purpose of the MAP is to ensure the good-faith application of a tax treaty.[23] The OECD's Manual on Effective Mutual Agreement Procedures describes how a nation's competent authority should effectuate that purpose: ''In the resolution of 'MAP' cases, a competent authority should engage in discussions with other competent authorities in a principled, fair, and objective manner,'' relying on such things as the commentary to the OECD model tax convention as an ''appropriate basis for the development of a principled approach.''[24] It is clear under the OECD model convention, and more clear under the treaty, that the U.S. and South Korean competent authorities are authorized to agree on principled grounds upon a meaning of the term ''use'' in article 6 of the treaty that captures the purpose of the treaty negotiators.

A. The treaty itself provides an effective tool for preventing an effective override of the treaty. As noted, article 2(2) of the South Korea-U.S. treaty provides that an undefined term in the treaty shall, ''unless the context otherwise requires, have the meaning which it has under the laws of the Contracting State whose tax is being determined.'' Article 2(2) of the treaty continues, explicitly providing that ''if the meaning of such a term under the laws of one Contracting State is different from the meaning of the term under the laws of the other Contracting State . . . the competent authorities may, in order to prevent double taxation or to further any other purpose of [the treaty], establish a common meaning of the term for purposes'' of the treaty.

In this case, the ''context otherwise requires.'' Following South Korea's unilateral abandonment of the mutually understood, economically sound principle, the meaning of ''use'' under the laws of the treaty parties differs.[25] The competent authorities may (and should) under the treaty establish a common meaning of the term ''use'' in accordance with this principle.

[17]Paragraph 8 of the commentary on article 12 of the OECD model convention (emphasis added). It is understood that South Korea relied in particular on the language emphasized.

[18]*See*, *e.g.*, 2005 Du 8641 (unofficial condensed English translation) (''given the territorial limitations of patent rights, exclusive rights of the patent owner to manufacture, use, transfer, rent, utilize, exhibit, etc. is effective only in the territory or the country where the patent is registered''); discussion at *supra* Section II.

[19]*See* 2011 Guhap 3891 (condensed unofficial English translation).

[20]*Id*.

[21]*Id*.

[22]*See* example in text *supra* at Section III.A.

[23]OECD, ''Manual on Effective Mutual Agreement Procedures'' (Feb. 2007). Competent authorities should also ensure the good-faith application of tax treaties in accordance with the OECD's model tax convention.

[24]*Id*.

[25]*See* discussion at *supra* sections II.B and III.

B. The OECD model convention supports this approach. The OECD model convention indicates that a term not specifically defined in the treaty shall have the meaning given under the law of the state whose tax is being determined *except as the context otherwise requires*, and the commentary explains that the context is determined by the intention of the states when signing the tax treaty, as well as by the meaning of the term in the legislation of the other state. The commentary thus concludes that the wording of article 3(2) allows competent authorities leeway in effectuating the purpose of tax treaties.

In full, article 3(2) of the OECD model convention provides:

> As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.[26]

Commentary to OECD model convention article 3(2), an ''appropriate basis for the development of a principled approach'' to treaty dispute resolution, clarifies that this paragraph provides a ''general rule of interpretation'' for undefined treaty terms; ''however, the question arises which legislation must be referred to in order to determine the meaning of terms not defined in the Convention, the choice being between the legislation in force when the Convention was signed or that in force when the Convention is being applied.''[27] While an OECD committee chose the latter interpretation for the general rule, the commentary continues, noting that this general rule applies ''only if the context does not require an alternative interpretation.''[28] The commentary emphasizes that ''the context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State.''[29] This commentary reflects the principle that ''a State should not be allowed to make a convention partially inoperative by amending afterwards in its domestic law the scope of terms not defined in the Convention.''[30]

If the South Korean competent authority needed additional authority, beyond the treaty, to effectuate the purpose of the treaty rather than an effective override of the treaty, the OECD model commentary clearly provides that authority.

V. Conclusion

Despite the existence of an effective tool to prevent effective treaty override, the South Korean competent authority has opted to not exercise its authority in this regard and instead has chosen to adhere to the amended CITL definition of use. The South Korean competent authority made this decision notwithstanding South Korean Supreme Court decisions to the contrary, notwithstanding the correct economic principle, notwithstanding the South Korean competent authority's previous interpretation of ''use'' for purposes of the treaty, and notwithstanding clear authority in the treaty to come to a different conclusion.

The reasons for the South Korean competent authority's position remain unclear. One would not want to conclude that the 2008 amendment of the CITL was intended to be a ''revenue grab'' vis-à-vis the United States[31] and that the South Korean competent authority views its role as protector of that revenue. If the amendment were not simply a revenue grab, however,

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[26]Article 3(2) of the OECD model convention.

[27]Paragraph 11 of the commentary on article 3(2) of the OECD model convention.

[28]*Id.* at para. 12.

[29]*Id.*

[30]*Id.* at para. 13. *Accord* the United States Model Technical Explanation Accompanying the United States Model Income Tax Convention of Nov. 15, 2006 (''model technical explanation'') (providing that ''the use of ''ambulatory'' definitions . . . may lead to results that are at variance with the intentions of

(Footnote continued in next column.)

the negotiators and of the Contracting States when the treaty was negotiated and ratified''). Thus, the model technical explanation provides that the reference to context otherwise requiring refers to a circumstance in which the result intended by the contracting states is different from the result that would obtain under the statutory definition. The Vienna Convention, to which South Korea is a party, is in accord, providing that a party to a treaty ''may not invoke the provisions of its internal law as justification for its failure to perform a treaty.'' Vienna Convention, article 27 (1969). Korea became a contracting country to the Vienna Convention in January 1980. Contracting countries to the Vienna Convention are bound by the Vienna Convention.

[31]South Korea has signed 77 tax treaties. *See* the Korean National Tax Service's listing of tax treaties with foreign countries, *available at* http://www.nts.go.kr/eng/resources/resour_02.asp?minfoKey=MINF7620080220173406. A review of those 77 tax treaties suggests that only four exclusively source patent royalties based on place of use. The remaining 73 tax treaties permit South Korean sourcing if the payer of the royalty is a resident of South Korea. The four South Korean tax treaties that appear to exclusively source patent royalties based on place of use are the South Korea-U.S. treaty, the South Korea-Venezuela tax treaty, the Papua New Guinea-South Korea tax treaty, and the Hungary-South Korea tax treaty. Considering these four treaty countries as a pool, from 2007 to 2010 (i) U.S. foreign direct investment in South Korea constituted over 94 percent of total inbound foreign direct investment and (ii) South Korean outbound foreign direct investment to the United States constituted more than 97 percent of total outbound foreign direct investment. *See* OECD, ''OECD StatExtracts, FDI flows by partner country.'' These statistics suggest that an effective override of the treaty as discussed herein would greatly increase South Korean tax revenues.

and the South Korean competent authority did not resolve these cases on the basis of a common understanding of the term ''use'' as described above, it would be hard to conclude that the South Korean competent authority's power to further the purpose of the treaty, as reflected in article 2(2) of the treaty itself, is significant. Are there other authorities within the Korean National Tax Service at work to constrain the legitimate power of the South Korean competent authority? This would be as troubling as the revenue grab explanation.

The South Korean competent authority's application of the amended CITL in the context of the treaty has the potential to effectively override the treaty and to undermine the basic purpose of the competent authority function to apply the treaty in good faith. The South Korean competent authority should take a principled approach to negotiations, relying on an existing, effective tools under the treaty and the commentary to the OECD model tax convention, to prevent an effective override of the treaty.

Royalties paid by a South Korean resident to a U.S. resident for patent rights registered in the United States and not in South Korea should not be sourced to South Korea under the treaty based on the amended CITL. Otherwise, the mutually understood, economically sound principle that prevents the sourcing of patent royalties to a jurisdiction in which the underlying patent is not registered dissolves and the treaty is made partially inoperative by an amendment to the scope of an undefined term in the treaty (''use'') enacted in the domestic laws of one treaty party after the treaty's signature. The context requires that the South Korean competent authority change course and employ the existing, effective tool detailed above to avoid an effective override of the treaty. ◆