Korean Tax Update

Samil Commentary

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Special Tax Treatment & Control Law Amended to Expand Tax Credits for National Strategic Technologies and Reintroduce Temporary Investment Tax Credit

The amended Special Tax Treatment Control Law was proclaimed on April 11, 2023 after being approved by the National Assembly in its plenary session held on March 30. The key objectives of the amended law include increasing the tax credit rates for facility investment in the semiconductor and other national strategic technology sectors and allowing an additional tax credit for facility investment during a one-year period of 2023 ('temporary investment tax credit'). Under the amended law, for example, where a small and medium-size enterprise (SME) makes investment in facilities to commercialize certain national strategic technology, a temporary investment tax credit ('ITC') shall apply at a rate of up to 35%, including 25% for investment in the current year and an additional 10% for incremental investment expenditure compared against the average investment made for the previous three years ('incremental investment tax credit').

Reintroduction of temporary investment tax credit: The temporary ITC has been reintroduced since it expired 12 years ago, and the tax credit will only be applicable to

investments made this year. Under the temporary ITC, the tax incentive rates will increase for facility investments made in 2023 for the commercialization of national strategic technologies as well as general and new-growth and source technologies. Incremental investment expenditure will be entitled to an additional tax credit of 10%, which is 2 to 3 times higher than the current rates (3% and 4%).

Investment Tax Credit Rates

Category of technology	Investment for current year (%)			For incremental investment (%)
	Large company	Medium-scale company	SME	
General	1 → **3**	5 → **7**	10 → **12**	3 → **10**
New-growth and source technology	3 → **6**	6 → **10**	12 → **18**	
National strategic technology	8 → **15**	8 → **15**	16 → **25**	4 → **10**

** Note: The Red Box represents increases in tax credit rates under the reintroduction of the temporary ITC while the blue box indicates increases in tax credit rates for national strategic technologies.*

Korea and Andorra Reach an Agreement and Initial the Income Tax Treaty for the Avoidance of Double Taxation

The Ministry of Economy and Finance (MOEF) announced on March 23 that Korea and Andorra have reached an agreement and initialled an income tax treaty for the avoidance of double taxation. The Korea-Andorra tax treaty is the first income tax treaty that Andorra has signed with an Asian country. It will come into force after being ratified by the parliaments of both countries. Key elements of the agreement include:

- **Permanent Establishment (PE)**: The treaty reflects the standards of the OECD base erosion and profit shifting (BEPS) project to tackle tax avoidance* (OECD Model Tax Convention on Income and on Capital 2017). (* Prevention of artificial avoidance of PE status through associated enterprises, expansion of the scope of agents exercising the authority to conclude contracts, reduction of the scope of independent agents, etc.)
- **Reduced withholding tax rates on income in the country of source:** ***Dividends***: 5% if the beneficial owner is a company which holds at least 10% of the capital of the company paying the dividends and 10% in all other cases / ***Interest***: 5% if the beneficial owner is a financial institution and 10% in all other cases/ ***Royalties***: 5%.
- **Prevention of tax treaty abuse:** Denial of treaty benefits for an arrangement where obtaining the treaty benefits such as reduced tax rates stipulated by the treaty is one of principal purposes of the arrangement.

According to the Ministry, the income tax treaty reflects primary changes* contained in the 2017 OECD Model Tax Convention and is expected to serve as a favourable precedent when Korea concludes new income tax treaties with other countries or revises existing tax treaties. (*Include expressly stating the purpose of preventing treaty abuse (title and preamble of the treaty), clarification for whether a fiscally transparent entity is a resident for treaty purposes (Article 1 (2), responding to hybrid mismatching), reinforced standard for PE threshold (Article 5, prevention of artificial avoidance of PE status through associated enterprises, expansion of the scope of agents

exercising the authority to conclude contracts, reduction of the scope of independent agents, etc.), stricter criteria for entitlement to benefits (Article 29, inclusion of principal purpose test, etc.).

Korea's Tax Expenditure Plan for 2023

The MOEF announced that the government's tax expenditure plan for 2023 was approved in the cabinet meeting on March 28, 2023. The plan indicates that the amount of national tax exemptions or reductions was projected to be KRW63.5 trillion in 2022 with the tax exemption ratio of 13.1%, which is measured as the ratio of national tax exemptions or reductions compared to the combined amount of national tax revenue and the tax exemptions or reductions. The increase in the national tax expenditure during 2022 (up from KRW57 trillion in 2021) stemmed from the strengthened fiscal support to facilitate corporate investment in research and development activities as well as job creations aimed at improving the economic vitality and the livelihood of the public. Despite the expanded tax expenditure, the national tax exemption ratio declined in 2022 (down from 13.5% in 2021) due to an increase in the total national tax revenue. In 2023, the national tax expenditure and the national tax exemption ratio are forecast to be KRW69.3 trillion and 13.9%, respectively. The tax expenditure plan for 2023 calls for terminating in principle or revisiting the existing 63 types of tax incentives including non-taxation which are scheduled to sunset at the end of 2023 or allowing a limited number of new tax expenditure initiatives which are required to secure future growth engines. According to the plan, the government will conduct a preliminary feasibility test relating to the introduction of new or additional tax incentives along with a mandatory in-depth review of exemptions or reductions which are scheduled to sunset and exceed an annual expenditure threshold or KRW30 billion. These test results will be reflected in the preparation of the government's tax reform proposal for 2023.

KCS Guidelines Allow to Apply FTAs for Goods of Foreign Corporations Warehoused in Free Trade Zones

The Korea Customs Service (KCS) will allow the issuance of certificates of origin necessary for the application of an FTA with respect to goods of foreign corporations originated from Korea and kept in free trade zone warehouses to be subsequently delivered outside of Korea (exports). To this end, the KCS has enforced the criteria for reviewing the country of origin of such goods on April 3, 2023. Previously, foreign corporations intending to export goods kept in free trade zones through logistics companies found it infeasible to get official documents necessary for the issuance of origin certificates even if those goods were originated from Korea. As a result, foreign exporters were not able to utilize FTAs as they had problems to respond to the process of origin verification by the customs authority of the country to which the relevant goods are exported. Since the Enforcement Rules of the Act on Special Cases of the Customs Act for the Implementation of FTA were amended on March 20, 2023, the KCS has enforced the Guidelines for Issuance of Certificate of Origin for Goods Stored in Free Trade Zones. The guidelines allow logistic companies located in free trade zones to obtain certificates of origin on behalf of foreign corporations, and to keep and submit supporting documents in order to respond to cases where the customs authority of an export destination seeks to verify the country of origin.

Rulings Update

Whether a tax refund request would be allowed based on subsequent event in case of the tax assessment on the deferred recognition of profit or loss by accounting fraud

According to Article 45-2(2)(4) of the Basis National Tax Law (BNTL), a taxpayer who has filed a tax return by a statutory due date or who has been determined the tax base and tax amount by the tax authority may submit an amended tax return for a tax refund request to the tax authorities within three months from the date of knowing that any of the subsequent events prescribed in the BNTL has occurred. The subsequent events for tax refund request include the case where the tax base or tax amount originally filed for a tax year (limited to the same type of tax), which is linked to other tax years being subjected to the determination or correction of the tax base or tax amount, exceeds the revised tax base or tax amount that should have been filed for the tax year as a result of the determination or correction for other tax years, among others.

This case concerns a company which deferred a deduction of losses arising from the disposal of tangible assets (the 'losses in question') to later years (i.e., from the years of 2011~2015 to the years of 2016~2020) with the intention of manipulating accounting profits and losses. The tax authorities disallowed the losses in question and assessed additional corporate income tax on the disallowed losses for the years of 2016~2020. The issue in this case is whether an amended tax return for a tax refund request based on the subsequent event should be allowed so as to allow a deduction of the losses in question from the company's taxable income for the tax years of 2011~2015 (as a result of the disallowance of the losses for 2016-2020 per the tax authority's assessment). Regarding this, the Ministry's authoritative interpretation provides that, where a taxpayer intentionally adjusts the timing of recognition/deduction of income/losses with the intention of manipulating accounting profits or losses, the taxpayer should not be allowed to submit an amended tax return for tax refund request based on a subsequent event such as the tax authority's correction or assessment set forth in the foregoing Article 45-2(2)(4) of the BNTL. (*Tax Policy Department of the MOEF 533, 2023.3.7*)

Previously, the Supreme Court also rendered a decision which was similar to the MOEF's interpretation above. The Supreme Court decision provides that: where a company had manipulated the timing of recognition of accounting income or losses by intentionally overstating profits or understating expenses and overreporting the resulting corporate income tax liability for a specific year, and by understating profits or overstating expenses and underreporting the resulting income tax liability for the following year, even though the tax authorities assessed additional corporate income taxes for the following year by adding the understated income to the taxable income or disallowing the overstated expenses for the following year, the company should not be allowed to submit an amended tax return for a tax refund request based on the subsequent event for the specific tax year by taking the position that there was a subsequent change in the basis for the tax base and tax calculation for the specific year. (*Daebeop2011du16971, 2013. 7. 11.*)

It seems that the MOEF and the Supreme Court took into consideration that a tax refund request based on a subsequent event is by its nature a special rule designed to protect taxpayers in the event there is a significant change in the basis for tax base or tax calculation, irrespective of the taxpayer's discretion, after the statutory filing due date for an amended tax return for tax refund

request has lapsed. *(Daebeob2007due13906,2007.10.12, Seoul Heangbeob2004guhap 25441, 2006.12. 22, etc*.) In this regard, they are of the view that, if the tax authority made an additional tax assessment by adjusting the incorrect timing of recognition of income or losses, without an intention of accounting fraud, etc. by the taxpayer, this may be regarded as a subsequent event eligible for tax refund request. (Shimsa-*Beobin-2017-0009, 2017. 7. 24*.) On the other hand, it should not be regarded as a subsequent event eligible for tax refund request where the tax authority made an additional tax assessment by adjusting the incorrect timing of recognition of income and losses arbitrarily made by the taxpayer for its intentional accounting manipulation. Those positions of the MOEF and the Supreme Court can be considered when a taxpayer submits a tax refund request based on a subsequent event as a result of the correction or assessment by the tax authority.

How to apply additional corporate income taxation on gains from the transfer of the land and buildings by a domestic company

Under Article 55-2(1)(3) of the Corporate Income Tax Law (CITL), where a domestic company transfers non-business purpose land, etc. prescribed in the CITL, the domestic company shall be subject to additional corporate income tax on gains from the transfer of the land, etc. at a tax rate of 10% (40% for gains from the transfer of unregistered land, etc.) in addition to the normal corporate income tax payable for the respective tax year ('additional corporate income tax on the transfer of non-business purpose land' or 'additional corporate income tax').

This case concerns a domestic company which transferred non-business purpose land together with other buildings, and had a net capital loss from the transfer by offsetting the gains on the transfer of the land against losses on the transfer of the buildings. The issue in this case is whether the domestic company should not be subject to additional corporate income tax on the basis that there was no net capital gain from the transfer of the land and the buildings as a whole or whether the domestic company should be subject to additional corporate income tax on the gains from the transfer of the land without being set off by the loss on the transfer of the buildings.

In its authoritative interpretation, the National Tax Service (NTS) concluded that, where a domestic company transfers both non-business purpose land subject to additional corporate income tax and the buildings not subject to additional corporate income tax as a whole, the additional corporate income taxation shall apply to the transfer of the land only, and gains and losses from the transfer of land and buildings should not be set off for corporate income tax filing purposes. *(Seomyeon-2021-beobin-5788, 2022. 3. 16.)*.

The reasons for imposing additional corporate income tax on the gains from the transfer of the land only, although both the land and the buildings were transferred, may include the following: the land, etc. subject to additional corporate income tax refers to houses and non-business purpose land, etc. prescribed in the CITL, and the scope of 'non-business purpose land' should be in principle limited to the land which is classified as property subject to property tax based on comprehensive aggregation under the Local Tax Law. As such, it would be reasonable not to offset gains or losses from the transfer of the land, etc. against gains or losses from the transfer of buildings which are not subject to additional corporate income tax under the CITL.

In this context, special care should be taken not to underreport nor underpay additional corporate income tax on gains from the transfer of land, etc. by offsetting them against losses

from the transfer of other buildings in case both the land and the buildings were transferred as a whole.

As mentioned above, additional corporate income taxation on gains from the transfer of non-business purpose land shall apply to land located in Korea which is subject to property tax based on the comprehensive aggregation, other than non-taxation, segregated taxation or separate aggregation of property tax, under the Local Tax Law (Article 55-2(2)(4) of the CITL), and such additional corporate income taxation has been introduced to stabilize the domestic real estate market. As such, the additional corporate income taxation shall not apply to the transfer of non-business purpose land held by a domestic company in a foreign country. (*Advance Ruling -2019-Beobryeonghaeseokbeobin-0054, 2019. 6. 5*.).

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