Korean Tax Update

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December 15, 2023

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I. Tax News

National Assembly Subcommittee Passes Modifications to the Initial Tax Reform Proposals for 2023

The Strategy and Finance Committee of the National Assembly approved at the end of November the governent's bill to amend 15 kinds of tax laws including the individual and corporate income tax laws. Provided below is a brief summary of selected key modifications to the initially proposed amendments the government had submitted to the National Assembly on September 1, 2023.

Child tax credit under the Individual Income Tax Law will increase to KRW150,000 for the first child, KRW200,000 for the second and KRW300,000 for the third child. Currently, the relevant tax credit amounts are KRW150,000, KRW150,000 and KRW300,000, respectively. In addition, grandchildren will also be included in the eligible scope for child tax credit.

Dividend received deduction (DRD) under the Corporate Income Tax Law requires a domestic company to own at least 10% of the shares or interest (5% for foreign subsidiaries engaged in overseas natural resources development) in the foreign subsidiary paying the dividends for a specified period to qualify for DRD. For foreign subsidiaries engaged in overseas natural resources development, the shareholding requirement will remain the same at 5%, rather than the initially proposed 2%.

Modifications to the originally proposed amendments to the Special Tax Treatment Control Law include**:**

- The 50% reduction in income tax on wages and salaries received by qualified foreign technicians and engineers for 10 years shall apply to those who started to work in Korea no later than December 31, 2023 under the current tax law. The amendment will extend the stipulated date for staring work to December 31, 2026 (rather than December 31, 2028 as initially proposed).
- Foreign expatriates and employees are eligible for a flat tax rate of 19% (20.9% including local income tax) on income earned in Korea for a period of 20 years under the current tax law. This flat tax rate is applicable to those who started to work in Korea no later than the end of December 2023. The amendment will extend the stipulated date to start to work to December 31, 2026 to be eligible for the flat-rate tax (rather than December 31, 2028 as initially proposed).
- New or additional tax incentives in relation to special opportunity zones include:
    - any business start-up or a new business place in such a zone will be qualified for 100% individual or corporate income tax exemption for the first five years and a 50% reduction for the subsequent two years.
    - Corporate income tax on gains arising from the sale of real estate in a metropolitan area by a company relocated in such a zone will be deferred until it disposes of any real estate acquired within such a zone.
    - Separate taxation at 9% will apply to interest and dividend income derived from long-term investments (of at least 10 years) made in investment funds aimed at fostering growth of such zones.

- Any business start-up or a new business place in Special Economic Zones for Peace will be entitled to 100% individual or corporate income tax exemption for the first three years and a 50% reduction for the subsequent two years.
- For credit card spending in 2024 which surpasses the amount of credit card expenditure in 2023, 10% of the amount exceeding 105% of the expenditure in 2023 will be deducted from taxable income, capped at KRW 1 million.
- The threshold for a special gift tax concession on family business succession (subject to a lower rate of 10%) will increase to KRW12 billion from KRW6 billion, while KRW30 billion was initially proposed.

Customs Act: A legislative framework will be established to allow a taxpayer to request the customs authorities to transmit its tax information to itself or a third party*. (* 1) a certified customs agent, a customs agency corporation, or a customs clearance company, etc., 2) a certified tax accountant or a tax firm, 3) a certified public accountant or a lawyer who can serve as a tax agent, or 4) a telecommunications service provider as prescribed by the Presidential Decree of the Act).

Government Announces Draft Amendments to the Presidential Decree in relation to Global Minimum Tax

With the global minimum tax rules (Pillar Two) to be enforced on January 1, 2024, the Ministry of Economy and Finance (MOEF) announced a bill to amend the Presidential Decree of the Law for Coordination of International Tax Affairs (LCITA), seeking public comments on the proposed rules concerning global minimum tax. Released on November 9, the bill is to specifically stipulate the provisions regarding matters in the new chapter of the LCITA related to the Pillar Two rules that were introduced in the domestic legislation at the end of 2022. The Ministry comments that when the Presidential Decree is amended as proposed, it would enable companies to analyze the impact of the global minimum tax rules, specifically the applicability of the global minimum tax rules and calculation of additional tax liabilities. The Presidential Decree of the LCITA will be amended and promulgated in December 2023 when it is finalized and approved by the cabinet meeting after reflecting public comments (November 9 to December 7). Key parts of the proposed amendments to the Presidential Decree are summarized below.

- **Clarification of Terms**: It will specify the definitions of key terms* and excluded entities**, clarifying the scope of excluded entities not subject to the application of the GloBE rules (*Group, Controlling Interest, Consolidated Financial Statements, etc./** a government entity, an international organization, a non-profit organization, a pension fund, an investment fund, etc.).
- **Computation of GloBE income or loss**: It will allow prescribed adjustments to financial accounting net income or loss
- **Computation of adjusted covered taxes**: It will reflect adjustments** to the covered taxes* of a constituent entity for a fiscal year which shall be equal to the current corporate tax expense recorded in its financial accounts

  * Taxes imposed on income or profits, including taxes levied in lieu of a generally applicable corporate income taxes, etc.

  ** Examples of adjustments: Addition of any amount of covered taxes accrued as an expense in the profit before tax in the financial accounts, and deduction of corporate tax expense which is not expected to be paid within three years of the last day of the fiscal year, etc.

Korea and Iran Agree to Revise the Income Tax Treaty for Avoidance of Double Taxation

Korea and Iran have agreed on a partial revision of the income tax treaty and initialled the agreement which includes amendments to the mutual agreement procedures (MAP). The revised tax treaty will go into effect after being officially signed and ratified by the two governments. Major points of the agreement include:

- Allow a taxpayer to file the application for MAP with the competent authorities in both contracting states, rather than the contracting state of which the taxpayer is a resident, and extend the application period for MAP from two years to three years;
- Expand the scope of information exchange in relation to taxes and strengthen the related obligation for cooperation; and
- Include a new provision regarding the entitlement to treaty benefits which should deny treaty benefits for an arrangement where obtaining the treaty benefits is one of principal purposes.

NTS to Raise the Annual Revenue Threshold for Random Selection of Periodic Audit Targets

Beginning from next year, the National Tax Service (NTS) will increase the annual revenue threshold from KRW 150 billion to KRW 200 billion. The threshold is a key element used to select targets for periodic audits which involve the random selection of audit targets among companies not subject to tax audits for at least four taxable years (at a five-year interval). The NTS has recently revised its internal rules governing corporate tax administration and procedures related to audits. The revised rules will take effect on January 1, 2024, following a notice inviting public comments from December 6 through 26, 2023. The NTS explained the threshold increase is necessary to ensure an adequate number of periodic audit targets and enhance audit efficiency, taking into account economic growth and the expanding scale of corporations.

National Tax Administration Reform Committee Considers Support Plans for Exporters

The NTS has announced tax administrative support plans for businesses with high export ratios. This announcement followed the discussions by the members of the National Tax Administration Reform Committee on December 1, 2023. Qualifying corporations and individual entrepreneurs will be excluded from a regular audit target selection process by the NTS. In addition, the NTS will provide guidance to assist these businesses in utilizing existing support programs, such as pre-screening for R&D tax credit and consultations on specific tax deductions as well as exemption and reduciton. (* if it is confirmed by a tip-off or external data collection that a taxpayer has engaged in a tax evasion, the taxpayer may be selected for tax audit targets). In this respect, the NTS will redefine those qualified for such support based on the export ratios in 2023, and determine a detailed plan for exporting companies by tax item to provide support in 2024 as well. (*Ex officio extension of corporate income tax payment deadline and a prior advice to the taxpayer entitled to tax administrative support, etc.).

Proposed Amendments to Reduce Liquor Tax Base to Drive down Prices

On December 1, the MOEF announced proposed amendments to the Presidential Decree of Liquor Tax Law and detailed enforcement rules to introduce the tax base reduction scheme for domestically manufactured alcoholic beverages which are subject to the taxation based on price (rather than volume). Under the proposed scheme, liquor taxes will be declared and paid based on the tax base determined by subtracting a specified amount from the ex-factory price, as per the standard sales ratio. This new scheme will be applicable to alcoholic beverages shipped from factories on or after January 1, 2024. The Ministry said the draft bills aim to address concerns about inequality in the determination of tax bases between domestically manufactured and imported liquors. While the former's tax base includes manufacturers' sale and administrative expenses, etc., the tax base for imported liquors does not include such expenses. Imported liquors are taxed at import customs clearance. The proposed scheme is anticipated to lessen the tax burden on domestically manufactured liquors and foster improved tax fairness. The standard sales ratio will be decided through deliberations by the members of a committee which will be formed under the NTS.

II. Changes in Tax Laws

Rules for the Application of a Tariff-rate Quota under Article 71 of the Customs Act

Article 71 (1) of the Customs Act (i.e. Tariff-rate Quota) permits the assessment of customs duties at rates lower than basic tariffs where it is deemed necessary to facilitate imports of specific goods for balanced supply and demand, enhance industrial competitiveness or stabilize the domestic prices. In response to ongoing supply shortages and price hikes in food products due to poor harvests, etc., and stabilize living expenses, the rules outlined in Article 71 of the Act were amended to increase the quota quantities of imported products for the tariff-rate quota. Specifically, for chicken and mangos, the quota quantities rose from 60,000 to 90,000 tons, and from 1,000 tons to 2,300 tons, respectively. Moreover, a 0% tariff-rate quota will be temporarily applied to eight categories of agricultural and processed foods, including green onions, bananas, butter, and cheese from November 17, 2023 to December 31, 2023. (*As amended by the Presidential Decree No. 33874; Nov 16, 2023*)

III. Rulings Update

Whether the corporate income tax on corporate earnings reserve can be deducted in calculating the corporate earnings reserve

Under Article 100-32(4)(2)(i) of the former Presidential Decree of the Special Tax Treatment Control Law (STTCL) (before the amendment on February 15, 2022), 'corporate income tax for a relevant year' is one of the adjustment items that can be deducted in calculating corporate earnings reserve for the relevant year. The issue in this case was on whether the 'corporate income tax and corporate local income tax on corporate earnings reserve' (collectively referred to as 'corporate income tax in question'), in addition to corporate income tax on taxable income, should be included in the scope of 'corporate income tax for a relevant year' that can be deducted in calculating corporate earngs reserve.

The taxpayer argued that the corporate income tax in question should fall within the scope of 'corporate income tax for a relevant year' based on the following grounds: the corporate income tax on corporate earnings reserve is actually paid out in cash but would not flow back into the company, and there is no specific tax provision which excludes the corporate income tax in question from the scope of 'corporate income tax for a relevant year.'

However, the Board of Audit and Inspection (BAI) disagreed and decided against the taxpayer, stating that: i) if the corporate income tax in question were allowed as a deduction in calculating corporate earnings reserve, the concerned corporate income tax amount would not be fixed and determined since it is calculated by applying a tax rate on the corporate earnings reserve, and so is dependent on the corporate earnings reserve amount under the calculation formula; and ii) the MOEF and the NTS have consistently interpreted that the term 'corporate income tax for a relevant year' refers to the amount of corporate income tax on the taxable income for a fiscal year (*Corporate Taxation Division of the MOEF-312,2016.3.30 and Seomyeon-2015-Beobryunghaeseokbeobin-2114,2016.3.30, etc*.). (*BAI 2023-simsa-32, 2023.11.23*)

Observation: Following the amendments to the Presidential Decree (Article 100-32(4)(2)(A) effective February 15, 2022) and the enforcement rules of the STTCL (Article 45-9(2) effective March 18, 2022), which explicitly stipulate that the term 'corporate income tax for a relevant year' being deducted in calculating corporate earnings reserve refers to the amount of 'corporate income tax on the taxable income for a fiscal year', it is anticipated that there may be no further disputes over the concerned issue.

Whether the payment for the acquistion of treasury stocks according to the Commercial Code would be treated as a non-business purpose loan to the shareholder

In this case, a Korean company acquired its treasury stocks from the shareholders in 2014 and 2020 through the legal procedures for the acquisition of treasury stocks pursuant to the Commercial Code (Article 341). However, in a tax audit, the Korean tax authorities challenged that although the treasury stocks were acquired through the legimate procedures under the Commercial Code, the concerned acquisitions should be regarded as non-ordinary transactions that lack economic reasonableness, other than a reduction in the company's taxable income due to additional interest costs on borrowings incurred for its acquisition of treasury stocks, etc., thereby producing the same result as a diverted support of loans to the shareholders who have transferred the treasury stocks to the company. As such, the tax authorities treated the payment for the acquisition of treasury stocks as non-business purpose loan to the shareholders, and assessed corporate income tax on the payment. A main issue in this case pertains to whether the payment for the valid acquisition of treasury stocks according to the Commercial Code would be treated as non-business purpose loan for corporate income tax purposes.

Regarding this, the Tax Tribunal decided in favor of the company, ruling that the tax assessment on the payment for the acquistion of treasury stocks by treating it as non-business purpose loan should be revoked. The Tax Tribunal's decision is mainly based on the following grounds that: i) it is difficult to treat the payment for the transfer of treasury stocks as a non-business purpose loan where the transfer of treasury stocks is a legitimate transaction; ii) in order to treat the payment as non-business purpose loan, the concerned transfers should be considered invalid, however, there is no dispute between the parties over the validity of the transfer of treasury stocks; iii) if the payment were nevertheless regarded as non-business purpose loan to the shareholders while the treasury stock transfer is considered valid, the shareholders would have to be deemed as gifting the treasury stocks to the company without receiving any consideration in return, which is not reasonable; and iv) considering the company's financial conditions, etc., there is a possibility of generating gains from the disposal of treasury stocks through the future resale of these stocks, and so, it is difficult to treat the treasury stocks as non-performing assets. (*Joshim2023jung0086, 2023.9.5*)

Observation: The recent court decision indicates that even if income decreases due to interest expenses incurred on additional borrowing to acquire treasury stocks, the payment for the acquisition of treasury stocks cannot be considered as a loan when the acquisition is legally valid and effective under the Commercial Code, and considering factors such as the corporate value, the treasury stocks are not considered as non-performing assets. This aligns with the previous decision by the Tax Tribunal, holding that the payment for the acquisition of treasury stock cannot be treated as non-business purpose loan as long as the transaction is valid. (*Joshim2018joong2655, 2018. 11. 14*). Furthermore, in a recent case the Supreme Court ruled that if the acquisition of treasury stocks is legally valid under the Commercial Code, the purchase price is considered a legitimate payment for the stocks and cannot be deemed a non-business purpose loan. The ruling also noted that considering the business activities of the company, there is a possibility of generating income, and therefore, it cannot be classified as a non-performing asset. It may be necessary to consider the Supreme Court decision in conjunction with the aforementioned Tribunal decision. (*Supreme Court2023du31263, 2023. 4. 27, Supreme Court2017du63337, 2021. 7. 29*.).

How to determine the share acquisition cost when calculating deemed dividends for the shares acquired through the exercise of stock options

This authoritative interpretation concerns the case where the shares acquired through the exercise of stock options are retired or reduced through the capital reduction with consideration after a special tax treatment such as non-taxation under the STTCL was previously applied to the gains from the exercise of stock options associated with the shares (i.e. the difference between the fair market value of the shares and the exercise price at exercise). A question arises as to whether, in calculating the deemed dividends from the capital reduction for the amount exceeding the share acquisition costs, the share acquisition costs should be based on their fair market value of the shares at the time of exercising the stock options or their exercise price.

In this regard, the NTS replied that, when calculating the amount of deemed dividends from capital reduction, the fair market value of the shares at the time of exercising the stock options should be considered as the amount paid by shareholders to acquire the shares (as specified in Article 17(2)(1) of the Individual Income Tax Law*). (Advance Ruling-2023-Beobgyusodeuk-0481, 2023. 9. 21*.)

Observation: Where the non-taxation applied to gains from exercising stock options (i.e., fair market value minus exercise price) and later the underlying shares are subject to deemed dividend taxation, it would likely trigger an unreasonable situation whereby the previous benefit from non-taxation would be offset against additional taxation on deemed dividend if the exercise price were regarded as the acquisition cost of these shares. This recent interpretation appears to resolve such inconsistency, suggesting that when calculating the amount of deemed dividends due to the retirement or reduction of shares acquired through the exercise of stock options, it is necessary to refer to this interpretation.

Whether the registration and license tax would be imposed on the debt to equity conversion pursuant to the approval of a rehabilitation plan

According to Article 26(2)(1) of the Local Tax Law (LTL), no registration and license tax shall be imposed on the registration at the request of a court on the rehabilitation or special liquidation of a company, whereas the registration for capital injection, capital increase or conversion of debt into equity shall be excluded from the non-taxation of the registration and license tax. Additionally, Ariticle 25(4) of the Debtor Rehabilitation and Bankruptcy Act (hereinafter referred to as the Debtor Rehabilitation Act) provides that the registration tax (currently registration and license tax) shall be exempt for the registration made pursuant to a court's approval of a debtor's rehabilitation plan. The issue in this case is whether the registration and license tax should be applied under the LTL or exempted under the Debtor Rehabilitation Law with respect to the registration for the debt to equity conversion made pursuant to the court's approval of the rehabilitation plan.

The appellant company argued that the impostion of registration and license tax on the debt to equity conversion pursuant to a court's approval of the company's rehabilitation plan would not be justified, considering the purpose of the Debtor Rehabilitation Act which should aim to facilitate a swift insolvency resolution process for financially distressed companies.

In this case, the Tax Tribunal found that: i) whether to apply the registration and license tax should be determined based on the LTL, and the provisions under the Debtor Rehabilitation Law cannot be referred to as the basis for the exemption from the registration and license tax; ii) it appears that the Debtor Rehabilitation Act stipulates the provisions for the non-taxation of the registration and license tax under the LTL as a reference provision; and iii) it is difficult to consider the provisions of the Debtor Rehabilitation Law as a special law over the LTL. Given these considerations, the Tribunal ruled that it would be reasonable to impose the registration and license tax on the concerned case. However, the Tribunal further ruled that considering that it is deemed impractical to make the filing and payment of registration and license taxes due to a conflict of these laws, it is unreasonable to impose a penalty in this case. (*Joshim2023Ji4093, 2023. 11. 7, Joshim2023ji 3665, 2023. 9. 27*)

Observation: There is a precedent where a court upheld the imposition of registration and license tax for debt-to-equity conversions which followed the approval of a rehabilitation plan. This precedent was a key reference used in reaching the recent tribunal decision. Furthermore, the Ministry of Justice has submitted a bill to the National Assembly aimed to address a discrepancy between the LTL and the Debtor Rehabilitation Law by removing the non-taxation provision for registration and license tax under the Debtor Rehabilitation Act. Additionally, the Ministry of Interior and Safety has submitted a bill to amend the LTL to the National Assembly, proposing an amendment to the non-taxation provision for registration and license tax to ensure non-taxation for registration referrals associated with capital increases, etc. during the rehabilitation process. These proposed bills are currently under discussions by the National Assembly.

The content is for general information intended to facilitate understanding of recent court cases and authoritative interpretations. It cannot be used as a substitute for specific advice and you should consult with a tax specialist for specific case.

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