Korean Tax Update
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Table of Contents

Tax News

- Government Seeking to Partially Amend Tax Laws to Expand Incremental R&D Tax Credit and Extend the Temporary Investment Tax Credit
- Korea-Taiwan Agreement for Double Taxation Avoidance Applies to Income Taxes from January 2024
- Ministry of SMEs and Startups Unveils Plan for Extension of SME Graduation in 2024 Economic Policy Briefing
- NTS Reports a Significant Improvement in Expediting the Settlement of Tax Appeal Cases
- MOEF Projects a KRW56.4 Trillion Decrease in National Tax Collections from the Budget for 2023

Changes in Tax Law

- Rules for the Application of a Tariff-rate Quota under Article 71 of the Customs Law
- Detailed Rules to Implement the Amended Local Tax Law
- Rules for Imposing Anti-dumping Duty on Imports of Aluminum Hydroxide Originating from China and Australia

Rulings Update

- Whether to include a reduction in share transfer price in gross income for tax purposes
- Whether to include treasury stock in calculating the ownership percentage for the application of the DRD rule
- How to determine the acquisition cost of shares acquired through the exercise of conversion rights of convertible bonds held by a domestic corporation
- Whether discounted golf course green fees constitute entertainment expenses or a sales discount for tax purposes

Tax News

Government Seeking to Partially Amend Tax Laws to Expand Incremental R&D Tax Credit and Extend the Temporary Investment Tax Credit

The government is planning to partially amend tax laws such as the Special Tax Treatment Control Law (STTCL) and the Individual Income Tax Law (IITL). Under the plan, it is seeking to increase tax credit rates for incremental research and development (R&D) expenditure and extend the existing temporary investment tax credit for one year. The government will seek to have the partial amendments approved in a temporary session of the National Assembly this February. Key highlights of the plan include:

□ Repealing the introduction of financial investment income taxation originally set to take effect on January 1, 2025.

□ Increasing the tax credit rate by 10 percentage points for the incremental portion of qualifying R&D expenditure over the previous year's expenses. This increase will apply to expenditure incurred between January 1 and December 31, 2024.

* Tax credit rate for incremental portion for general technology
(excluding national strategic technology and new growth and source technology)

	Current	Proposed
Small and midsize Enterprise (SME)	50%	60%
Middle standing Enterprise	40%	50%
Large Company	25%	35%

□ Extending the temporary investment tax credit for one year until December 31, 2024.

*Temporary Investment Tax Credit Rate

	Basic Credit			Additional Credit for incremental expenditure
	Large Co.	Middle-standing Enterprise	SME	
General technology	3%	7%	12%	10%
New growth and source technology	6%	10%	18%	
National strategic technology	15%	15%	25%	

- Offering a 70% reduction in individual consumption tax and other surtaxes for new passenger cars purchased and registered by an owner satisfying certain requirements. If an individual wants to benefit from the tax reduction, they are required to have a car registered prior to December 31, 2013, continue to maintain ownership of the car as of December 31, 2023, and purchase and register a new passenger car (excluding diesel cars) within a two-month period before or after the cancellation date of the existing car registration. The tax reduction shall be capped at KRW1 million in individual consumption tax, KRW300,000 in education tax and KRW130,000 in value added tax (VAT).

Korea-Taiwan Agreement for Double Taxation Avoidance Applies to Income Taxes from January 2024

The Agreement between Korea and Taiwan for the avoidance of double taxation with respect to income taxes entered into force on December 27, 2023. The Agreement shall have effect in respect of taxes withheld at source, for amounts payable on or after January 1, 2024, and in respect of other taxes, for the taxable year beginning on or after January 1, 2024. Provided below are key highlights of the Agreement.

- The term "**permanent establishment"** (PE) encompasses the following, among others:
  a) a building site, a construction, assembly or installation project or supervisory activities lasting more than six months; and
  b) the furnishing of services (including consultancy services) by an enterprise through employees if activities of that nature continue within a territory for a period or periods aggregating more than 183 days in any twelve-month period.
- **Dividends, interest and royalties** arising in a territory and paid to a resident of the other territory may be taxed in that other territory at a tax rate not exceeding 10% of the gross amount if the beneficial owner of the income is a resident of that other territory.
- **Capital gains** derived from the alienation of property excluding immovable property, etc. shall be taxed in the territory of which the alienator is a resident. However, gains derived from the alienation of shares in a real property-rich company situated in that other territory (real property representing more than 50% of total assets) may be taxed in that other source territory. Also, gains derived from the alienation of shares by a large shareholder (owning 25% or more of shares at any time during the twelve-month period preceding the alienation) may be taxed in that other source territory.
- **Limitation on benefits** provision has been incorporated, ensuring that treaty benefits, such as non-taxation or reduced rates, are not granted to a transaction where obtaining such benefits is one of principal purposes of the transaction. This aligns with Article 7(1) of the OECD Multilateral Convention to Implement Tax Treaty Related Measures.

Ministry of SMEs and Startups Unveils a Plan for an Extended Grace Period for SME Graduation in its Economic Policy Briefing for 2024

The Ministry of SMEs and Startups announced on January 11, 2024 its policy direction for 2024, including a plan to extend the grace period for graduation from the status of small and medium-sized enterprise (SME) from three to five years. In this respect, the Ministry will draft a bill to amend the Basic Law on Small and Medium-sized Enterprises with an expectation that it is approved by the National Assembly within the first quarter of this year. Subsequently, it plans to amend the Presidential Decree of the Special Tax Treatment Control Law that defines the scope of SME for tax incentive purposes.

NTS Reports a Significant Improvement in Expediting the Settlements of Tax Appeal Cases

According to the National Tax Service (NTS), there has been a significant enhancement in expediting the settlements of tax appeal cases with more cases settled by statutory deadlines and a reduced average duration of settlements. To further enhance transparency and taxpayers' rights, the NTS plans to introduce a notification program aimed to keep taxpayers informed about the outcomes of consultations held by the NTS Advisory Committee on the Review of Taxation Facts (the 'Advisory Committee'). This committee is an internal body of the NTS that conducts thorough analysis of tax issues and provides expert opinions to assist tax examiners in making informed decisions regarding tax assessments. While access to the Advisory Committee's consultations has been restricted to tax examiners since its introduction in February 2023, the NTS will share the outcome of the Advisory Committee's review with taxpayers beginning from 2024. The NTS anticipates this initiative will provide taxpayers with useful insights for their possible tax appeals.

MOEF Projects a KRW56.4 Trillion Decrease in National Tax Collections from the Budget for 2023

The Ministry of Economy and Finance (MOEF) has projected a significant decrease in Korea's national tax collections for 2023. The projection indicates that the national tax collection is expected to total KRW344.1 trillion, which represents a decrease of KRW51.8 trillion from the previous year's collection of KRW395.9 trillion and a KRW56.4 trillion decrease against the budgeted amount for 2023 (KRW400.5 trillion). The decline in tax revenue may be attributed primarily to a significant decrease in the collection of corporate income taxes due to reduced profits of corporations. The economic challenges since the fourth quarter of 2022 have resulted in smaller corporate profits earned in 2022 and the first half of 2023, and therefore, corporate income tax collections have decreased by KRW23.2 trillion from the previous year. In addition, collections of capital gains taxes declined KRW14.7 trillion in 2023, influenced by the decline in real property and other asset markets. Furthermore, a reduction in imports has led to a decrease of KRW7.9 trillion in value-added tax (VAT) collections for the year.

The MOEF anticipates a further decline in tax revenues with the total national tax revenue forecast (excluding special tax accounts) to be KRW356.1 trillion for 2024. This forecast, included in the publication 'Korea's Budget Summary for 2024,' released by the Ministry on February 5, 2024, shows an 8.7% decrease from the budgeted amount for 2023 (KRW 390.3 trillion). Domestic taxes, which account for the largest portion of national tax collections, are expected to reach KRW321.6 trillion, reflecting a 10.2% decrease from 2023. (* Domestic taxes include individual income tax, corporation tax, inheritance and gift tax, VAT, individual consumption tax, securities transaction tax, stamp tax, while excluding customs duties, transportation, energy & environment tax, education tax, comprehensive real property holding tax.)

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 goods for balanced supply and demand, enhance industrial competitiveness, or to stabilize domestic prices. In response to ongoing supply shortages and to help stabilize living expenses, the rules outlined in Article 71 of the Act were amended to apply a 0% tariff-rate quota to green onions from January 19 to March 31, 2024 and a 0% to 10% tariff-rate quota for 24 categories of imported products including bananas and mangoes from January 19 to June 30, 2024. (As amended by the Presidential Decree No. 34154, January 18, 2024)

Detailed Rules to Implement the Amended Local Tax Law

The Basic Local Tax Law has been amended to consolidate additional charges and heavy additional charges collected from taxpayers making late payments into a unified category of late payment penalties. Subsequently, detailed rules have been drafted to address shortcomings in the existing system by: i) including information on late payment penalties in written tax notices distributed to taxpayers, notifying them of their property and vehicle tax obligations; ii) adjusting the cap on administrative expenses, deductible from taxes collected by individuals responsible for collecting and paying to local governments motor vehicle tax for motor driving, from 2/10,000 to 5/10,000 of the tax collected; and iii) requiring the taxpayer to indicate whether they are a related party of the seller on the acquisition tax return. (Ordinance of the Ministry of the Interior and Safety No. 457, January 22, 2024.)

Rules for Imposing Anti-dumping Duty on Imports of Aluminum Hydroxide Originating from China and Australia

While imports of aluminum hydroxide originating from China and Australia are subject to anti-dumping tariffs, the rules shall apply a 0% anti-dumping tariff to aluminum hydroxide used to manufacture artificial marble. It has been confirmed that the imported aluminum hydroxide for such uses does not, or is not expected to, pose substantial damage to domestic manufacturers. (MOEF Ordinance No. 1037, January 24, 2024.)

Rulings Update

Whether to include a reduction in share transfer price in gross income for tax purposes

In this ruling, a domestic corporation which had acquired shares in a company filed a lawsuit claiming compensation for damages against the former shareholders of the company. Later, both the transaction parties agreed to drop the lawsuit by executing an amended annexed agreement to the share transfer agreement whereby the domestic corporation's payment amount at the closing of share transfer transaction was reduced by a specified amount from the agreed payment amount at the time of share transfer ('reduction amount in question'). The main issue in this case is whether the reduction amount in question should be treated as separate compensation income, which is not related to the share acquisition cost, and included in the domestic corporation's gross income according to Article 15(1) of the Corporate Income Tax Law (CITL) (i.e. Scope of Gross Income) and Section 15-11-1 of the CITL Basic Rules (*Gibon Tongchik* in Korean), or whether it should be considered as an adjustment to the share purchase price, and thus the acquisition cost of shares in the asset account of the domestic corporation should be reduced by the reduction amount in question according to Article 72(2)(1) of the Presidential Decree of the CITL (i.e. Acquisition Cost of Assets).

In response to this issue, the National Tax Service (NTS) issued an advance tax ruling, providing that where the transaction parties executed the annexed agreement to the original share transfer agreement at the time of share transfer, which allows the parties to adjust the share transfer price, the reduction amount in question made pursuant to the annexed agreement should be deducted from the share acquisition cost. This authoritative interpretation suggests that the reduction amount in question should not be viewed as compensation for damages or losses, distinct from the payment for share acquisition. Rather, it should be treated as an adjustment to the share purchase price in accordance with the original agreement between the transaction parties, and the share acquisition cost of the domestic corporation should be reduced by the reduction amount in question accordingly. (*Advance Ruling-2023-Beobgyubeobin-0708, 2023.11.27*).

Observation: In a precedent authoritative interpretation, where a domestic company paid the provisional purchase price in accordance with a conditionally agreed post-settlement clause of an agreement upon business transfer, and later it filed a lawsuit regarding the appropriateness of the purchase price, even if a reduction amount to the purchase price is received as compensation for damages at the court decision, the reduction amount at issue should be deducted from the acquisition cost of the assets acquired through the business transfer, rather than being included in the gross income of the domestic company (*Advance ruling-2022-Legal Corporation-1306, March 10, 2023*). Similarly, the Tax Tribunal ruled that where a company transferred shares with a post-settlement condition for the transfer price, and later it paid compensation for damages under the agreement on the adjustment of transfer price, the concerned compensation paid should be deducted from the transfer price of the shares (*Joshim2013seo2201, 2014. 1. 20*.).

Therefore, even if a domestic company, which had acquired shares, received a payment from the former shareholders in the name of compensation for damages, where the payment is in substance a reduction amount being made as an adjustment to the share transfer price based on an original agreement or a court decision, it would be reasonable to reduce the share acquisition cost by the payment amount, rather than treating the payment as compensation income, which is distinct from the share acquisition cost. However, whether a payment received after the share acquisition should be treated as compensation income distinct from the payment for share acquisition or a post-adjustment of transfer price should be carefully reviewed based on all relevant facts such as the share and purchase agreement, details of agreements between the parties, and court decisions.

Whether to include treasury stock in calculating the ownership percentage for the application of the DRD rule

Under the dividends received deduction (DRD) rule (Article 18-2(1) of the CITL), dividends received by a domestic company ("recipient company") from another domestic company ("paying company) are excluded from the recipient company's gross income in accordance with the following DRD rates: 100% if the recipient company owns at least 50% shares in the paying company, 80% if the recipient company owns at least 20% but less than 50% of the paying company, and 30% if the recipient company owns less than 20% of the paying company.

The main issue in this ruling is whether treasury stock should be included in the total number of issued shares in calculating the ownership percentage for the purpose of applying the DRD rule. In this case, if treasury stock is included, the recipient company's ownership ratio is 42%, and the 80% DRD rate should apply. However, if treasury stock is excluded, the substantive ownership percentage would rise to 62% and the 100% DRD rate should apply.

The authoritative interpretation provides that in calculating the ownership percentage, it should be based on the substantive ownership ratio (62% in this case) by excluding treasury stock from the total number of issued shares. This interpretation aligns with the legislative purpose of the DRD rule aimed at resolving potential double taxation of a dividend recipient company and a dividend paying company. It also aims to prevent the inconsistency in the DRD rate of the recipient company depending on whether the paying company owns treasury stock. Additionally, the interpretation suggests that the DRD regime is designed to calculate the ownership percentage solely based on the number of shares with dividend claim rights by excluding treasury stock without dividend claim rights from the total number of issued shares. (*Advance Ruling-2023-Beobgyubeobin-0747, 202311.23*)

Observation: This interpretation from the NTS states that treasury stock without dividend claim rights should be excluded from the total number of issued shares, while the recent authoritative interpretation from the MOEF clarified that non-voting preferred shares should be included in the total number of issued shares. (*Corporation Tax Division of the MOEF-240,2006. 3. 27 and*

Guidelines for Enforcing the CITL, Section 18-2-17 (2-2)). In this regard, it is considered that there are consistent interpretations from both the NTS and the MOEF that when calculating the ownership percentage for the application of the DRD rule, even if there is no explicit provision regarding the scope of the total number of issued shares under tax laws, whether to include certain shares in the total number of issued shares should be determined based on dividend claim rights, rather than voting rights.

How to determine the acquisition cost of shares acquired through the exercise of conversion rights of convertible bonds held by a domestic corporation

According to Article 72(2)(1) of the Presidential Decree of the CITL, the acquisition cost of assets purchased by a domestic corporation shall be the sum of the purchase price and incidental expenses. Also, the acquisition cost of shares acquired through the conversion of debt to equity is determined by the market value of the shares at the time of acquisition as prescribed in Article 72(2)(4-2) of the Presidential Decree of the CITL. In this ruling where shares are acquired by a domestic corporation through the conversion of convertible bonds, the issue is whether the acquisition cost of the shares should be regarded as the purchase price of the convertible bonds or whether the market value of the shares acquired through the exercise of the conversion rights should be regarded as the acquisition cost of the shares, and whether the difference between the market value of the shares and the purchase price of the convertible bonds ("conversion gain") should be included in the corporation's gross income for tax purposes.

In this regard, the authoritative interpretation indicates that the acquisition cost of shares acquired through the exercise of conversion rights of convertible bonds should reflect the actual purchase price of the shares as prescribed in Article 72(2)(1) of the Presidential Decree of the CITL. This interpretation is based on the perspective that the taxable value of shares acquired through the exercise of conversion rights and the value of convertible bonds extinguished through the exercise of conversion are the same. Therefore, the conversion gain recorded in the accounting books due to the exercise of the conversion rights is considered as an unrealized gain that is merely a discretionary valuation gain according to Article 18(1) of the CITL (*i.e. Non-inclusion in Gross Income*) and it cannot be included in the gross income for tax purposes. (*Gijune-2023-Beobmubeobin-0120, 2023. 11. 28.*).

Observation: There is another precedent ruling, providing that the acquisition cost of shares acquired through the conversion of convertible bonds to equity should be based on the market value of the shares at the time of conversion, rather than the purchase price of convertible bonds (*Legal Interpretation Division of the NTS-4233, 20026.10.4*). However, this ruling dealt with the special case where the conversion of convertible bonds to equity took place as part of the debt repayment based on an agreement between the bondholder and the debtor, distinct from the ordinary exercise of conversion rights based on the unilateral expression by the bondholder (Article §516 ② and §350 ① of the Commercial Act, i.e. Effectuation of Conversion). In this regard, in the case of the conversion of convertible bonds through the ordinary exercise of conversion rights, rather than the debt-to-equity conversion due to default on debt, it may be reasonably considered that the acquisition cost of the shares should be based on the purchase price of the convertible bonds, and the difference between the market value of the shares and the purchase price of the convertible bonds should not be included in the gross income.

Additionally, the MOEF interprets that when calculating capital gains tax on the transfer of shares, which were previously acquired through the exercise of conversion rights of convertible bonds, by a resident that is not a domestic corporation, the acquisition cost of shares deducted from the transfer price should be based on the purchase price of the convertible bonds (Tax Policy Division of the MOEF-2089, 2023.10.20). It is worth noting that the existing interpretations take a similar approach in determining the acquisition cost of domestic shares acquired by a foreign corporation or a nonresident through the exercise of conversion rights of certain convertible bonds issued abroad according to domestic regulations, stating that the acquisition cost of such shares should be the actual purchase price of the convertible bonds (CITL Gibon Tongchik, Section 92-129…4 ① (1) and IITL Ginbon Tongchik, Section 126-0…1 ① (1).

Whether discounted golf course green fees constitute entertainment expenses or a sales discount for tax purposes

This case concerns the tax treatment of a discount on green fees (i.e. golf course admission fees) offered by a company to its golf club members. The company has operated both a membership-based golf course and a public golf course. As part of a business strategy to cope with a decrease in golf course revenue, the company provided its golf club members with a discount on public course green fees. In this case, a question arises as to whether the discount amount should be treated as sales discount and be excluded from the company's revenue under the CITL.

Regarding this, the NTS interpretation states that, where a domestic corporation operating both a membership-based golf course and a public golf course offers a discount on public course green fees to customers who hold membership rights for its membership-based golf course, if the discount consistently applies to all the customers satisfying the pre-announced criteria that were approved at the shareholder's meeting of the corporation as part of a strategy to increase sales revenue, the discount amount should be treated as sales discount under the CITL and should be excluded from the corporation's revenue in accordance with Article 11(1) of the Presidential Decree of the CITL (*Seomyeon-2023-Beobin-0155,2023.8.21*.)

Observation: In another tax ruling where a corporation operating a golf course provides its shareholders or employees with a discount on green fees without a justifiable reason, or offers discounted green fees for specific customers only, the NTS interpreted that the discount for its related parties (e.g. shareholders, employees) should be subject to the rule for denial of unfair transactions between local related parties, and the discount for unrelated parties should be treated as entertainment expenses, subject to disallowance (now termed 'corporate business promotion expenses') as outlined in Article 25 of the CITL (*Corporation Tax Division-458,2010.5.17. Online Writing Consultation 2 Team-2281, 2006.11.9*). However, the Tax Tribunal ruled that where a corporation operating a golf course offered a discount on green fees to specific customers (rather than an unspecified number of people) based on predetermined preferential criteria in order to increase sales revenue, the discount amount would constitute sales discount rather than entertainment expenses. (*Gookshim2004jung4722, 2005.4.18*). In this regard, it is necessary to determine the green fee discounts as either entertainment expenses or sales discount based on a comprehensive analysis of all detailed facts and circumstances, as well as precedent cases.

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