

Korean Tax Update

# Samil Commentary

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## The New Government Announces Its Economic Policy Framework

Korea's new government announced on June 16 its economic policy framework aimed at boosting growth and reviving growth momentum amid a global and domestic economic slowdown. Provided below is a brief summary of tax measures that the economic policy framework identifies to facilitate corporate investment and innovation as well as job creation.

**Tax changes to enhance corporate investment and job creation:** (corporate income tax) the four corporate income tax brackets would be simplified and the highest corporate tax rate (currently, 25%) would be lowered in light of international tax competitiveness, etc.; (taxation of dividends) to help avoid the double taxation of corporations, tax on domestic- or foreign-sourced dividends would be realigned by way of increasing the deduction rate for dividends received by a domestic company from its domestic subsidiary and providing a new deduction for dividends received by a domestic company from its foreign subsidiary (currently, a domestic company would have to add such dividends to its taxable income, and it may claim a foreign tax credit for foreign tax paid by the foreign subsidiary); (loss carryforward) a deduction limit for tax losses carried forward would increase to help ease the burden of economic losses derived from the COVID-19 pandemic, etc.; and (additional



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tax on excess corporate reserve) there would be the abolishment of the existing 20% additional tax on excess corporate reserve which is intended to encourage the spending of corporate retained earnings for funding facility investment and payroll increases, in light of its effectiveness and efficiency, and to align with international standards.

**Expansion of incentives for investment in advanced technologies and job creation:** (national strategic industrial technology, etc.) the existing preferential tax credit scheme for medium-scale companies (as well as small and midsize enterprises) would be extended to large companies to apply a uniform credit rate to both large- and medium-scale companies as a part of a plan to encourage investment in advanced technologies which are considered as contributing to national economic security; semiconductor and OLED technologies would be entitled to the expanded scope of tax credits for national strategic technologies and new growth or source technologies; (integration of employment tax credits) employment-related tax credits would be expanded and integrated into a unified credit scheme; (emerging services sector) the gap between manufacturing and services sectors in terms of incentives for investment, employment and startups would be narrowed, and tax incentives would be expanded for emerging services businesses (e.g. over-the-top media service).

Further, the government highlights in its economic policy the revitalization of capital markets and venture capital to enable sustainable growth of real economy. In this regard, it calls for postponing the taxation of financial investment income by two years, curtailing the scope of individuals subject to capital gains tax on the sale of listed shares (i.e., limited to those with shareholding worth KRW 10 billion or more per stock type) and preemptively reducing securities transaction tax (from 0.23% in 2022 to 0.20% in 2023).

### Proposed Amendment to Expand Support for Reshoring Companies

The Ministry of Trade, Industry and Energy announced on June 22 a bill to amend the Presidential Decree of the Act on Assistance to Reshoring Korean Companies, seeking public comments on the bill (from June 22 through August 1, 2022). The bill is aimed at expanding support for companies transferring a business operation, that was previously moved overseas, back to Korea as specified in the new government's economic policy framework announced a week earlier. The bill proposes an amendment to the definition of 'establishment of a new or additional business place in Korea' under the law. According to the proposed amendment, if a company brings production facilities offshored back to its existing factory or business place in Korea, it would also be regarded as a new or additional business place established in Korea. As of now, if reshoring companies satisfy the relevant requirements, they would be entitled to individual or corporate income tax reduction under the Special Tax Treatment Control Law.

### The AEO Mutual Recognition Agreement between Korea and Indonesia Becomes Effective at the end of June 2022

The Korea Customs Service (KCS) announced that the Authorized Economic Operator (AEO) Mutual Recognition Agreement between Korea and Indonesia became effective on June 30, 2022. The AEO is a program that provides companies approved by the KCS with

benefits including curtailed customs inspection and accelerated customs clearance procedures for exports and imports. 97 countries around the world have adopted the AEO scheme. As the Mutual Recognition Agreement has come into effect, AEOs in both countries would experience benefits like faster customs clearance in the other country with a reduced quantity or scope of products to be subject to customs inspection. This would bring about a reduction in both clearance time and costs. (\* As of June 2022, 276 Korean companies and 61 Indonesian companies are expected to enjoy the benefits of the recent agreement). The KCS is seeking to conclude the AEO mutual recognition agreements with an increasing number of foreign countries including the Middle East and Vietnam where trade barriers tend to be higher.

### Korea's Corporate Tax Revenue Grows 12.3% in 2021

The National Tax Service (NTS) announces selected national tax statistics quarterly before publishing the National Tax Statistics Yearbook at the end of December every year. As part of this process, the NTS has released the quarterly national tax data at the end of June which included 175 data items or 32.1% of a total number of 546 items for 2021. The key parts of the national tax statistics released in the second quarter of 2022 include: 1) in response to a steady increase in the number of corporate tax returns filed, the corporate income tax payable grew 12.3% to KRW 60.2 trillion in 2021 (KRW 53.6 trillion in 2020); 2) a total of 7.46 million valued added tax (VAT) returns were filed in 2021, a 5.0% increase from 2020, while by industry the real estate rental sector and the manufacturing sector represented the largest share of the total number of VAT returns filed and the total sales revenue, respectively; 3) the imposition of comprehensive real estate holding tax grew 87.2% to KRW 7.3 trillion in 2021 in line with a 36.7% rise in the number of returns filed from the previous year; 4) the total value of inherited property increased 140.9% in 2021 from the previous year with securities, by type of property, making up the largest share of the value, while the total value of gifted property increased 15.8% in 2021 with buildings, by type of property, accounting for the largest share of the value; and 5) all forms of consumption taxes\* payable rose 1.3% from 2020 to KRW 38.9 trillion in 2021. (\*includes excise tax, liquor tax, transportation, energy and environment tax, securities transaction tax and stamp tax).

### Notification of Discontinuance Proceedings in relation to the Investor State Dispute Case filed by Lone Star

The Ministry of Justice announced that the World Bank's International Centre for Settlement of Investment Disputes (ICSID) has declared discontinuance of proceeding on an investor state dispute between the Korean government and Lone Star Funds, a US private equity fund. With the declaration, the ICSID will announce the final ruling as early as within 120 days after the notice of discontinuance of proceedings pursuant to Articles 38 and 46 of the ICSID Convention, Regulations and Rules (or within 180 days if there is any special reason for them not to render a decision within 120 days). This case was filed by Lone Star Funds against the Korean government on November 21, 2012 with the ICSID in Washington, US. The declaration of discontinued proceeding was made six years after the final court date assigned for hearing ended in June 2016. When a final judgement in this case is given, the

government plans to analyse the final judgement and take subsequent measures led by a task force of competent ministries.

## Rulings Update

### The meaning of 'the accounting period for which the profit distribution takes place' and 'owns' in applying a tax rate of 5% on dividends under the Korea-Japan treaty

According to Article 10 (2)(a) of the Korea-Japan tax treaty, if the beneficial owner of dividends paid by a resident of a Contracting State is a resident of the other Contracting State, the tax so charged shall not exceed 5% of the gross amount of the dividends, provided that the beneficial owner owns at least 25% of the voting shares issued by the company paying the dividends during the period of six months immediately before the end of the accounting period for which the distribution of profits takes place.

With respect to the requirement for applying the reduced tax rate of 5% on dividends under the tax treaty, a recent authoritative interpretation of the Ministry of Economy and Finance (MOEF) deals with questions as to whether: 1) the accounting period for which the distribution of profits takes place refers to (i) the accounting period subject to dividends or (ii) the accounting period in which the dividend declaration date falls; and 2) in determining the ownership ratio and the holding period of shares in a dividend paying company, the term 'owns' should also include the indirect ownership of the shares in the dividend paying company through an intermediate holding company and, if included, it should apply only where the intermediate holding company is not the beneficial owner (i.e., the nominal owner) of the dividends.

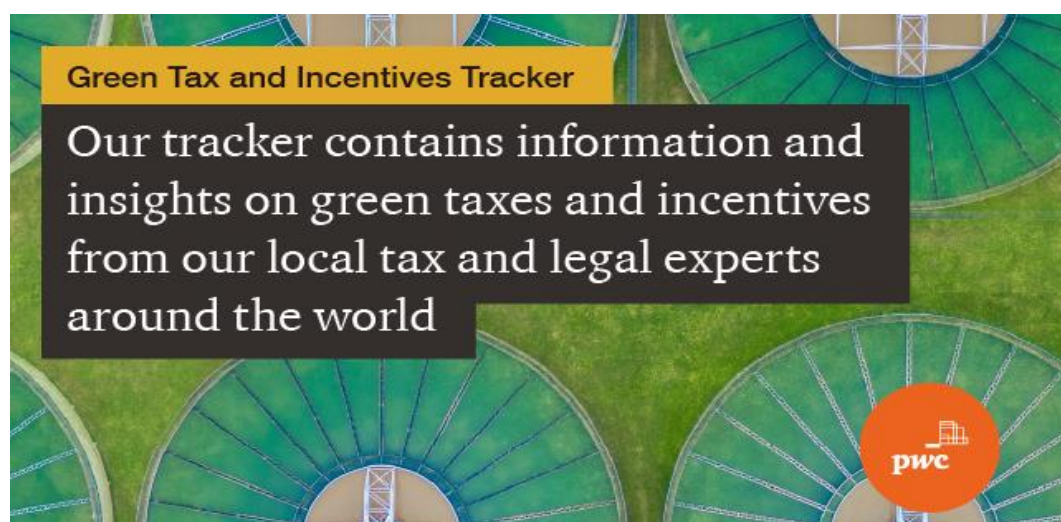
The MOEF interpretation indicates that the accounting period for which the distribution of profits take place refers to the accounting period subject to dividends and the term 'owns' also includes the indirect ownership of shares in a dividend paying company through an intermediate holding company, while it is irrelevant whether the intermediate holding company is the nominal owner of the dividends. (*Tax Policy Division of the MOEF-408, 2022.5.26*)

It is noteworthy that the MOEF's latest interpretation shows a change in its position from its earlier interpretation that the accounting period for which the distribution of profits take place refers to the accounting period in which the dividend declaration date falls (*International Tax Cooperation Division of the MOEF-352, 2016, 8.3*), whereas it is consistent with a precedent Supreme Court ruling on the same issue that supported the accounting period subject to dividends (*Daebeop2018du54408, 2021.7.21*). In addition, it is meaningful in that the latest interpretation acknowledges the term 'owns' in a broader scope than its previous position (*International Tax Cooperation Division of the MOEF-147, 2016. 3. 24.*) that the scope of the term 'owns' includes the indirect ownership of shares in a dividend paying company through an intermediate holding company which is not the beneficial owner of dividends.

## Whether an heir should operate a family business as of the date of inheritance in order to qualify for a deduction for the succession of family business

Currently, Article 18(2)(1) of the Inheritance and Gift Tax Law (IGTL) provides that in the case of the succession of family business, the family business must have been continuously operated by its heir for at least 10 years to qualify for a deduction of certain amounts from the taxable value of property inherited. The requirements for a deduction for family business succession was originally stipulated under the former Presidential Decree of the IGTL, including that the qualifying family business should be a business which the heir had continuously run for a certain period of time as of the 'date of commencement of inheritance' (the 'date of inheritance' or 'the phrase in question'). However, the phrase in question was deleted under the amended Presidential Decree of the IGTL at the end of December 2007 and the provision setting out the definition of qualifying family business has been moved to the IGTL (rather than its Presidential Decree). Consequently, there is no specific provision stipulating that the heir should run a family business as of the date of inheritance in order to qualify for a tax deduction. A question has been presented as to whether a deduction for the succession of family business could apply if the heir failed to run the family business as of the date of inheritance.

Regarding this, the MOEF interpreted that a deduction for family business succession could even apply where the heir failed to run the family business as of the date of inheritance. (*Tax Law Management Division of the MOEF-571, 2022.5.30*). In its latest interpretation, the MOEF appears to consider that currently there is no specific provision in the IGTL requiring a qualifying heir to run the family business as of the date of inheritance, and that the tax deduction regime is aimed at facilitating the succession of family businesses for small and midsize as well as medium-scale enterprises. In their previous interpretations, the MOEF and the National Tax Service expressed that a deduction for family business succession would be applicable if the reason why an heir failed to run the family business as of the date of inheritance were only because of unavoidable health reasons of the heir. (*Property Taxation Division of the MOEF-4808, 2014.11.14, Seomyeon-2020-BeobryeonghaeseokJaesan-4808, 2021.8.25*). It is considered that the latest interpretation may be construed in favor of taxpayers compared to the previous interpretations and referred to in future cases involving a deduction for family business succession.





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