Korean Tax Update

Samil Commentary

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Saemangeum International Investment Promotion Zone Designated for Corporate and Individual Income Tax Breaks for Five Years

The national industrial complex in Saemangeum has recently been designated as an international investment promotion zone, providing companies that invest in this zone with tax exemptions and reductions for five years. With the government's aim of encouraging private sector investment in Saemangeum, amendments to the Special Tax Treatment Control Law were made to extend the existing tax incentives to investment in the Saemangeum investment promotion zone, effective January 1, 2023. In addition, the Special Act on Promotion and Support for Saemangeum Project was amended on December 27, 2022 to come into force on June 28, 2023. With the amended Special Act taken into effect, the government has officially designated the Saemangeum International Investment Zone. Companies that start businesses or establish new business places in this zone will be eligible for tax breaks that include 100% exemption from corporate income tax and individual income taxes for the first three years and a 50% reduction for the subsequent two years. Furthermore, companies will be exempt from charges for occupying and using public waters (e.g. state-owned rivers used for public purposes) for a period of 10 years. To qualify for these benefits, companies must meet certain criteria, including a minimum investment ranging from KRW500 million to KRW2 billion and a minimum of 10 to 30 fulltime employees (a minimum investment of KRW2 billion and at least 30 employees required for manufacturing businesses). The investment promotion zone is a kind of special economic zone aimed at providing tax breaks and incentives to attract investors to the Saemangeum Project Area. Interested investors can apply for the designation of an investment promotion zone with the Administrator of Saemangeum Development and Investment Agency. Alternatively, the Administrator may designate in its capacity an area with the intention of

promoting investment. Designation plans are subject to approval and are made public following the deliberation by the Saemangeum Committee.

NTS Implements a New System of Purchaser-issued Tax Invoice This July

The National Tax Service (NTS) has implemented in July a new system of purchaser-issued tax invoices for the supply of tax-free goods or services. This system enables purchasers (or recipients) of goods or services to issue tax invoices themselves with confirmation from a district tax office if the supplier fails to issue a tax invoice for the supply of tax-free goods or services. The introduction of this system* aims to help taxpayers handle expense records more easily and enhance the transparency of receipts and issues of tax invoices (**Article163-3 of the Individual Income Tax Law amended at the end of December 2022*). The new system applies to transactions with a supply value of KRW50,000 or more, provided that an application is filed with the competent tax office. The application must be submitted within six months from the end of the tax period in which the date of supply falls. Once purchasers (applicants) receive transaction confirmations from the competent tax office, they can proceed to issue a purchaser-issued invoice to the supplier. However, if both the applicant and the supplier receive a transaction confirmation from the head of the competent tax office, purchaser-issued invoices may not be issued. The new system applies to the supply of tax-free goods or services on or after July 1, 2023.

NTS Substantial Progress in Offshore Tax Evasion Investigations

The NTS announced that a total of KRW4 trillion in taxes were collected as a result of investigations of offshore tax evasion over the last three years. The average annual tax collection from these investigations exceeded KRW1.3 trillion. There was a continuous increase in the amount of tax levied per case of offshore tax evasion investigation, recording KRW6.81 billion in 2021. This figure was approximately seven times higher than the amount imposed in general corporate tax investigation cases (KRW980 million). In addition, the NTS announced that investigations of 52 taxpayers have been undertaken for suspicions of offshore tax evasions. The investigations focus on three primary types of examples, such as: 1) shifting income to overseas through manipulating the volumes of exports to a foreign controlled subsidiary, applying lower prices than market prices or unduly directing exports to a company owner-controlled paper company (19 taxpayers); 2) diverting offshore investment proceeds to paper companies in foreign countries by taking advantage of liberalized capital flows or transferring properties or funds to donees, disguising them as overseas investments to avoid gift taxes (12 taxpayers): and 3) concealing the existence of a permanent establishment in Korea by multinational companies or manipulating transaction details to shift income to foreign countries and avoid taxation in Korea (21 taxpayers). Starting this year, the NTS has made it one of their key performance indications to monitor and measure the amount of tax imposed through such investigations. It will increase capabilities to further enhance its ability to counter attempted offshore tax evasion.

Export Award Winning SMEs to Be Exempt from Being Selected for Periodic NTS Audit

The Korea International Trade Association (KITA) and the NTS have agreed to exempt award-winning exporters from being selected as audit targets by the NTS. These export award winners will be identified by the KITA based on their export records during the period from July 1, 2022 through June 30, 2023. Based on the export records in 2022, approximately 1,700 small and midsized enterprises (SMEs) are eligible for the award. In aggregate, these companies recorded total exports of USD114.5 billion in 2022, accounting for 15% of the overall exports of all SMEs. The KITA will provide the NTS with a list of qualifying SMEs for the award this year. The NTS will provide those selected SMEs with benefits such as the extension of statutory due dates for payment and expedited processing of tax refunds, etc. in addition to an exemption from being selected as audit targets.

Rulings Update

Whether a penalty for late payment of the special tax for rural development would be imposed on the corporate income tax refunded through a tax refund request

In this case, a taxpayer claimed a tax refund through an amended corporate income tax return filing to apply a tax credit for employment increase. The tax authority accepted the tax refund claim and refunded the corporate income tax to the taxpayer while it imposed a 20% special tax for rural development ('special surtax') on the refunded corporate income tax. (Under the Act on the Special Tax for Rural Development, a reduction or exemption of corporate income tax, etc. listed in the Act is subject to the special surtax at a rate of 20% on the reduced or exempted tax amount). The issue in this case is whether the taxpayer should be subject to penalties for the late payment of the special surtax on the refunded corporate income tax because the taxpayer failed to pay the special surtax by the original payment due date, or it is not subject to such penalties for the late payment of the special surtax by treating a part of the refunded corporate income tax (previously overpaid) as a prepaid special surtax.

In this regard, there are several cases where the Tax Tribunal has concluded that since the special tax for rural development is a separate tax item from the corporate income tax and is in nature an extra tax charged on the primary tax such as the corporate income tax, in cases where the special surtax is additionally charged on a reduced corporate income tax liability per a tax refund claim for the application of a tax credit, it is reasonable to view that part of the refunded corporate income tax previously overpaid should constitute the prepaid special surtax, rather than an underreporting of special surtax intentionally or by mistake. (*Joshim2017Seo3110, 2017. 9. 14, Joshim2014Jeon0764, 2014. 4. 24. etc.*). On the contrary, there were authoritative interpretations issued by the NTS indicating that a late payment penalty should be applied to the special surtax resulting from a tax refund request. (*Tax Collection Division-1202 2011. 11. 28, Tax Collection Division-1249 2011. 12. 9.).*

In the recent authoritative interpretations, however, the NTS and the Ministry of Economy and Finance (MOEF) stated that, where the corporate income tax (primary tax) is partially refunded based on a tax refund request accepted by the tax authority and the special surtax is separately levied and notified, the refunded amount of corporate income tax should be considered as a prepaid amount of tax for the purposes of calculating penalties for the late payment of the special

surtax *(Seomyeon-2022-Jingse-3543, 2023. 6. 22, Tax Policy Division of the MOEF-1197, 2023. 5. 23.).* This means that the refunded amount of corporate income tax per a refund request should be treated as being already paid by the statutory due date for the payment of the special surtax and the primary tax (corporate income tax). Consequently, the penalty for the late payment of the special surtax should not be imposed on the refund amount.

Moreover, the NTS recently withdrew its existing authoritative interpretations that supported the imposition of penalties for the late payment of the special surtax tax where the special surtax was levied on top of primary taxes such as corporate or individual income tax and the taxes were subsequently refunded through a tax refund request based on tax credits, exemptions or reductions claimed. (*Tax Collection Division-1202 2011. 11. 28, Tax Collection Division-1249 2011. 12. 9*.). The withdrawal of these NTS interpretations appears to be an acceptance by the NTS to its latest authoritative interpretation and the existing Tribunal judgments (*Joshim 2017 Seo 3110, 2017. 9. 14., etc.*) that a penalty for the late payment of special surtax should not be imposed on the surtax being charged on the primary tax refunded per a tax refund request. (*Streamlined NTS Legislative Interpretations, 2023.6.29*)

The recent authoritative interpretation appears to have resolved the controversy over the imposition of penalties for late payment when the special surtax is imposed on the refunded corporate or individual income tax following a tax refund request based on tax credits, exemptions or reductions. In addition, it is noted that non-filing or underreporting penalties (Articles 47-2(1) and 47-3(1) of the Basic National Tax Law) do not apply to the special surtax. Therefore, a company should not be obliged to pay penalties for late payment, non-filing or underreporting of the special surtax in the case where the company receives a refund of corporate income taxes through an amended return filing for tax credit, exemption or reduction claims.

Whether foreign bad debts that are uncollectible due to excessive senior debts would be treated as tax deductible

According to Article 19-2 of the Corporate Income Tax Law (CITL) and Article 19-2(1)(8) of the Presidential Decree of the CITL, receivables that are uncollectible due to the closing of business by a debtor are considered as bad debts and can be included in deductible expenses. In this case, a domestic company has outstanding foreign accounts receivables from a foreign debtor which has filed for dissolution. It has become impossible to collect these foreign debts because they are also owed to a secured senior debtor (with priority over other debt). The issue in this case is whether the domestic company can include these receivables in deductible expenses, considering that they would constitute receivables that are uncollectible due to the debtor's closing of business, which is one of qualifying reasons for bad debt deduction.

In light of a recent authoritative interpretation by the NTS, where an overseas debtor filed for dissolution and does not operate a business thereafter, and it is confirmed that the collection of foreign accounts receivables is not possible due to senior notes in spite of the domestic company's proper procedures, the receivables can be considered uncollectible due to the closing of the debtor's business. Consequently, they can be included in deductible expenses. (*Advance Ruling-2022-Beobgyubeobin-1254, 2023. 3. 8*.)

Regarding the meaning of uncollectible debts due to the closing of business, Supreme Court rulings state that it should be objectively confirmed as uncollectible in its entirety due to the closing of the debtor's business (*Daebeop2004Du13158, 2005. 3. 10. etc*.). Based on the existing Supreme Court cases (*Daebeop2012Du 14224, 2015.3.26, Daebeop2006Du1098, 2008. 7. 10*), it is interpreted that the closing of business which qualifies for a tax deduction should be determined based on the substantive closing of business, rather than the mere reporting of business closing to the tax office.

In addition, an authoritative interpretation by the NTS indicates that, if there is no chance of collecting receivables in the absence of any possibility of a distribution based on subordinated debentures held by domestic corporations, bad debt expenses can be allowed even before the completion of the distribution of remaining assets, following the resolution of bankruptcy for the issuer of such debentures (*Seoie46012-10785, 2001. 12. 20. etc*.). Further, the NTS interpreted that both foreign and domestic receivables should be treated equally when determining their eligibility for bad debt deduction (*Corporation Tax Division-184, 2014. 4. 17, Seomyeon Online Consulting Team 2-2150, 2005. 12. 22*.). This means that if the conditions for bad debt deduction are met, uncollectible foreign debts due to the closing of business, including those determined uncollectible due to excessive senior debt, can be allowed as deductible expenses as long as the foreign debtor is not in fact engaged in business operations.

Accordingly, where a domestic or overseas debtor is not engaged in normal business operations and is in fact bankrupt, and it is practically impossible to collect the debt owed because it is a subordinated debt rather than a senior debt, the receivable can be treated as a deductible bad debt even before the declaration of bankruptcy or business cessation of the debtor, considering the receivable as an uncollectible debt due to the discontinuance of business. However, it is necessary to note that a tax deduction of bad debts can be allowed only if they are properly recorded as bad debt expenses on a company's books, since the legal rights to claim such receivables have not been extinguished, but still exist. (*Article 19-2(3)(2) of the Presidential Decree of the CIT and Daebeop2001Du489, 2002. 9. 24*.).

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