Korean Tax Update
Samil Commentary

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Electric Vehicles Added to the list of National Strategic Technology Sectors Eligible for Investment Tax Credits

The government proclaimed on June 7, 2023 the partially amended Presidential Decree of the Special Tax Treatment Control Law (STTCL) and Enforcement Rules of the STTCL which extend the existing investment tax credits for certain electric vehicle (EV) and hydrogen manufacturing facilities. The latest partial amendment is a subsequent step to an earlier amendment to the STTCL in April 2023 that increased the tax credit rates for facility investments in national strategic technology sectors. Under the recently amended Presidential Decree and Enforcement Rules of the STTCL, the scope of national strategic technologies and facilities to commercialize such technologies has been expanded to include: 1) five categories of technologies and three categories of facilities in the future mobility sector such as highly efficient EV driving system technology, EV power conversion and charging system technology and manufacturing facilities, etc. and 2) five categories of technologies and five categories of facilities in the hydrogen sector such as water electrolysis-based clean hydrogen manufacturing technology and facilities as well as hydrogen fuel storage and supply device manufacturing technology and facilities, etc.

Korea and Portugal Agree to Revise the Income Tax Treaty

Korea and Portugal have agreed on amendments to the income tax treaty which include the adjustment of withholding tax rates on investment income in the country of source. The two countries reached an agreement on May 18, 2023 to accommodate changes in economic relations and international standards since the income tax treaty between the two countries was concluded in 1996 and took effect in 1997. The revised tax treaty will go into effect after being officially signed and ratified by the two governments. Key features of the initialled tax treaty are set out below:

- The criteria for the permanent establishment (PE) exemption will be strengthened in accordance with the recommendations by the OECD BEPS (base erosion and profit shifting) initiatives (i.e. the 2017 update to the OECD Model Tax Convention on Income and on Capital), including: the stricter determination of preparatory and auxiliary activities, the prevention of abuse of PE status through associated enterprises and the expansion of the scope of contract concluding agents.
- The reduced tax rate on dividends will be lowered from 10% (if the beneficial owner is a company that directly owns at least 25% of the company paying the dividend for **two years** prior to the payment of the dividend) to 5% (if the beneficial owner is a company that directly owns at least 25% of the company paying the dividend for **one year** prior to the payment of the dividend). The reduced tax rate on interest will be lowered to 10% from 15%.
- Interest arising in respect of export financing will be added to the scope of interest exempted from tax in the country of source.
- Profits derived from the rental of containers, in addition to profits derived from the rental on a bareboat basis of ships or aircraft will be included in the scope of profits which an enterprise of a country derives from the operation in international traffic of ships or aircraft, etc. (taxable only in the country).
- To streamline the taxation of business profits derived from branches, etc., it will provide further clarification on the application of the arm's length principle between headquarters and branches.
- To enhance the effectiveness of the exit tax enforcement which began in Korea in January 2018, a new provision will be added to resolve double taxation which may arise when an actual transfer of assets, which were subject to exit tax, takes place.

KCS Is Temporarily Suspending Customs Audits for an Increased Number of Companies

The Korea Customs Service (KCS) is temporarily suspending its planned audits for 28,000 small and midsize enterprises (SMEs) in 19 selected sectors. This is a significant increase from 5,148 companies in 15 sectors selected for the temporary suspension of customs audits last year. Specifically, the target groups for suspended customs audits include those which had annual imports of USD 100 million or less in 2022. The target groups comprise companies that have been recognized by the KCS and other government bodies for their performance in foreign trade and the government's preferred strategic sectors. Out of the 19 target groups for suspended customs audits, 17 groups will not be required to file a written application for suspended customs audits. For the remaining 2 groups, an audit

suspension will be granted based on the applications filed by companies with job retention or creation plans. (*Retention plan: SMEs meeting the annual import threshold must maintain the same level of employment as the previous year. Creation plan: All companies that meet the annual import threshold, irrespective of their size, must increase their full-time employee count by 1-3% compared to the previous year). The target groups of companies will not be subject to customs audits for one year from July 1, 2023 through June 30, 2024, and enjoy benefits such as the extension of the due date for payment of customs duties and an installment payment of duties.

NTS Announces Measures to Overhaul Tax Investigation Procedures to Enhance Taxpayer Rights and Protection

The National Tax Service (NTS) announced measures aimed at enhancing taxpayer rights and protection through an overhaul of tax investigation procedures. Key points of the measures are outlined below:

- To provide small and midsize taxpayers with more time to prepare, a tax audit notification will be issued 20 days (15 days, currently) in advance of an audit. This measure applies to corporate taxpayers with an annual turnover of less than KRW 50 billion as well as sole proprietors with an annual turnover of less than KRW 10 billion, which are subject to periodic tax audits.
- The duration of field audits will be reduced to the level of 50% to 70% of the overall tax audit duration for eligible companies which demonstrate transparent accounting practices and cooperative data submittance. A pilot test of this measure will be implemented for targets selected for periodic tax audits conducted by the Seoul and Jungbu NTS Regional Offices. The pilot test is scheduled to continue through the end of the year, with the intention of expanding it to all tax offices in the future.
- To prevent excessive and unreasonable collection of information and documents during tax investigations, requests for comprehensive information will be generally prohibited. This measure aims to ensure that tax investigators do not ask for excessive or unnecessary information during the course of their investigations.
- A new hearing process will be introduced to allow taxpayers to express their opinions on contentious issues before tax assessment. Initially, a pilot test of this hearing process will be carried out by the Seoul NTS Regional Office through the end of December 2023 with plans to extend it to all tax offices nationwide.
- A new procedure will be introduced to require the audit team to provide an audited taxpayer with a written explanation of audit findings and reasons for additional tax assessment, review results of taxpayer opinions, appeal procedures, etc. within 20 days after the completion of the audit procedure.
- A new pre-assessment review procedure will be established within tax investigation bureaus of the NTS regional offices. A combined group consisting of an audit team, review team and expert team will be formed to conduct an in-depth review on key tax issues on which taxpayers and examiners disagree. The head of the investigation bureau will ultimately determine whether to impose tax considering the findings of this review.

Foreign Financial Account Reporting Requirement Extended to Overseas Virtual Asset Accounts This Year

The NTS has announced that starting from this year, Korean residents and domestic companies must report their foreign bank and financial accounts including overseas accounts holding virtual assets by June 30, 2023 (where the total amount in those accounts exceed the reporting threshold of KRW500 million in aggregate balance as at any month-end during 2022). Overseas accounts holding virtual assets refer to accounts opened with overseas virtual asset service providers including cryptocurrency exchanges as well as overseas virtual asset wallet providers with which digital currencies are stored. Considering that the existing reporting requirement is extended to overseas virtual asset accounts for the first time this year, the NTS provides services to help taxpayers with timely and correct reporting. The reporting is subject to the post-filing verification by the NTS which has relied on data obtained through inter-governmental agreements for exchanges of financial information and data collected by other institutions including the Financial Intelligence Unit. Failure to comply with the reporting obligation results in a penalty of up to 20% of the unreported (under-reported) amount. In addition, if the unreported (or under-reported) amount exceeds KRW 5 billion, it may subject the taxpayer to imprisonment for up to two years and a list of those who are non-compliant may be disclosed.

Rulings Update

Whether gift tax would be imposed on individual shareholders of a corporation which has received excess dividends due to the waiver of the largest shareholder

Under the Inheritance and Gift Tax Law (IGTL), where the largest shareholder, etc. in a corporation waives all or part of its right to receive dividends from the corporation, and another corporate shareholder of the corporation, which is a related party of the largest shareholder, receives dividends in excess of the dividends determined in proportion to its shareholding ratio in the corporation (the 'excess dividends') due to the waiver of the largest shareholder, the excess dividends (net of relevant income tax) would be characterized as a gift asset to the related party of the largest shareholder and be subject to gift tax (the 'provision in question', *Article 41-2 of the IGTL*). The so-called "provision for the gift of excess dividends" is intended to prevent taxpayers from abusing unproportionate dividends as an anomalous means for gift tax avoidance.

A recent authoritative interpretation by the NTS deals with the case where the largest shareholder (X) of A Corporation waived its right to receive dividends and B Corporation, which is another shareholder of A Corporation, received excess dividends due to the waiver of the largest shareholder, and B Corporation was wholly owned by the children (Y) of the said largest shareholder. The issue of this case was whether the provision in question would apply to the individual shareholders (Y) of B Corporation on the basis that B Corporation received the excess dividends from A Corporation. The NTS interpreted that gift tax would not be imposed on the individual shareholders (Y) under the provision in question. *(Seonyeon-2022-Beobgyujaesan-3155, 2023. 3. 23.)*

In this ruling, the grounds for interpretating that the provision in question would not apply to the individual shareholders of the corporation receiving the excess dividends may include the following:

i) it would be reasonable to limit the scope of the application of the provision in question to related parties which hold shares in the corporation paying dividends (as prescribed in Article 41-2(1) of the IGTL); and ii) the provision in question would be subject to the provision for the prevention of double taxation of gift tax (*Article 4-2(4) of the IGTL*), which states that where a corporation is liable for corporate income tax on gift assets or profits, the shareholders of the corporation should not be subject to gift tax on the same gift assets or profits.

However, it should be noted that if a specific corporation, 30% or more of whose shares are directly or indirectly owned by its controlling shareholders, etc., receives excess dividends, the specific corporation could be deemed to be gifting the excess dividends to the controlling shareholders by applying the provision for deemed gifts of profits through transactions with the specific corporation under the IGTL (i.e. *Article 45-5(1)(1) of the IGTL*) according to the guidance on the application of the IGTL and the interpretation by the Ministry of Economy and Finance (*Property Taxation Division-434, 2019.6.19*). Therefore, it is important to note that the recent interpretation stating the non-imposition of gift tax to individual shareholders above was issued solely based on the provision in question (*i.e. Article 41-2 of the IGTL*). Care should be taken not to extend and apply this interpretation to cases where gift tax is imposed based on the provision for deemed gifts of profits through transactions with a specific corporation (*i.e. Article 45-5 of the IGTL*).

How to apply the provision for the prevention of double tax reductions to land where two or more local tax reduction provisions apply to a part of the land

Where two or more provisions that provide for local tax reductions are applicable to the same taxable object (e.g., land), the Special Local Tax Treatment Control Law (SLTTCL) prevents the duplicative application of reduction provisions and mandates the application of only the highest reduction rate among the local tax reduction provisions (*the 'provision for the prevention of double tax reductions', Article 180 of the former SLTTCL effective before March14, 2023*). The issue of this case was how to apply the provision for the prevention of double tax reductions to a land lot where a piece of the land is designated as an urban natural park area (eligible for a 50% reduction of property tax) and another piece is designated as a cultural heritage protection area (eligible for a 100% exemption from property tax), while a part of these pieces of land is subject to both area designations.

Regarding this, the Ministry of Interior and Safety ruled that for the piece of the land lot being designated as either the urban natural park area or the cultural heritage protection area, the relevant provision for property tax reduction should be separately applied to each piece of the designated area. For the part of the pieces of the land lot subject to both area designations, the provision for the highest rate of property tax reduction among other reduction provisions should be chosen and applied. *(Local Tax Relief Division-846, 2023. 4. 14.)*

The recent interpretation indicates that instead of applying one tax reduction provision to the entire land lot by treating it as a single taxable object, the land lot should be divided into different pieces, and a relevant tax reduction provision should apply to each piece of the land lot if the piece is eligible for only one tax reduction provision while a more favourable tax reduction provision can be chosen and applied to the pieces if they are eligible for two or more tax reduction provisions. This interpretation is considered reasonable in that the same reduction effect would be obtained, regardless of whether a taxpayer owns the land as either a single lot or separate lots.

Similarly, according to Article 127(7) of the Special Tax Treatment Control Law (STTCL) (i.e. *Prevention of Duplicate Tax Support*), where two or more tax reduction provisions are applicable to capital gains arising from the transfer of land by a resident, the resident is required to choose and apply only one of the applicable provisions. Additionally, where a particular tax reduction provision is applied to capital gains from the transfer of one piece of land, the remaining piece(s) may be eligible for different reduction provisions. As such, the STTCL allows a taxpayer to choose different provisions of capital gains tax reduction for each piece of land even if all pieces of the land are transferred as a whole.

Lastly, with respect to the tax provision that the highest tax rate shall apply if two or more capital gains tax rates are applicable to the transfer of a single asset under the former Individual Income Tax Law (IITL) (*Article 144(1) of the IITL, effective before December 23, 2014*), the Supreme Court ruled that in the case where land is divided between business purpose land and non-business purpose land, they should be treated as separate assets, subject to heavy tax rates for the non-business purpose land and normal progressive rates of capital gains taxes for the business purpose land, respectively. (*Daebeop2012du15371, 2014. 10. 30.*). The Supreme Court ruling above was subsequently codified into the amended IITL, which came into effect on December 19, 2017. Accordingly, when dealing with a land lot that has distinguishable purposes or uses for different parts of the land, it will be necessary to conduct a separate review on whether to apply different rates on property tax reductions or capital gains taxes by taking into account the recent authoritative interpretation.

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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