Korean Tax Update

Samil Commentary

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The Government Announces the Amended Presidential Decrees of Tax Laws and a Bill to Amend the Relevant Enforcement Rules

The Presidential Decrees of tax laws were amended and proclaimed on February 28, 2023. The amended Presidential Decrees include a few changes to the original bill to amend the Decrees. The government also announced on February 22 a bill to amend Enforcement Rules of 19 tax laws to implement details set out in the amended tax laws and Presidential Decrees thereof.

A few selected changes contained in the amended Presidential Decrees are summarized below.

- In order to apply the dividend received deduction (DRD) rules for dividends received from a foreign subsidiary, a domestic company must own at least 10% of the shares or interest in the foreign subsidiary paying the dividends for at least six months prior to the dividend record date. In this regard, the amended Presidential Decree of the Corporate Income Tax Law (CITL) clarifies the scope of qualifying foreign subsidiaries with respect to the six-month period in case of a tax qualified corporate restructuring (merger, spin-off or property contribution in kind). In other words, where a domestic company acquires shares, etc. in a foreign subsidiary from another domestic company through a tax qualified restructuring, the six month period shall begin from the original acquisition date of the relevant shares by the latter company prior to the transfer of the shares to the former company on the restructuring with respect to qualifying foreign

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subsidiaries eligible for the DRD.

- Under the original bill, for a foreign grandchild (or second-tier) subsidiary to be eligible for an indirect foreign tax credit, a foreign subsidiary must have been directly holding at least 25% of the shares or interest in the foreign grandchild subsidiary for at least six months prior to the dividend declaration date or a domestic company must have been holding at least 25% of the shares or interest in a foreign grandchild subsidiary through a foreign subsidiary. The amended Presidential Decree lowers the 25% threshold of shareholding in a foreign grandchild subsidiary to 10% for at least six months prior to the dividend record date, rather than the dividend declaration date, in order to bring the rule into alignment with the eased criteria for a foreign subsidiary eligible for indirect foreign tax credits.
- Previously, the original bill proposed to expand the scope of education tax base such that fees received by banks, etc. in return for their insurance agency services should be additionally included in the education tax base of the banks, etc. However, the final decision was made not to adopt the original proposal but to maintain the current rule.

Provided below are proposed changes contained in the government's bill to amend the Detailed Enforcement Rules.

- The scope of facilities to commercialize national strategic technologies is expanded from the current 31 categories of facilities in three sectors (semiconductors, secondary battery and vaccine) to 37 categories of facilities in four sectors by newly adding a display sector and including additional categories of facilities in display* and semiconductor** sectors. In general, the applicable tax credit rates for qualifying facility investment are 1%, 5% and 10% for large companies, medium-scale companies and small and midsize enterprises (SME), respectively. In case of facilities to commercialize the predesignated strategic technologies, higher rates of investment tax credits apply (8% for large and medium-scale companies and 16% for SMEs). (*AMOLED (Active Matrix Organic Light Emitting Diode), Micro LED, Quantum Dot, Nanomaterials Display, etc. and **system semiconductor test equipment manufacturing facilities and facilities to commercialize such next-generation memory chip as processing-in-memory (PIM), ultra-high vacuum technology, and power-efficient analog integrated circuits, etc.)
- The scope of facilities to commercialize new growth and source technologies is expanded from 181 categories of facilities to 190 categories in the existing 13 industrial sectors including future cars and carbon neutral technologies. Most of the newly added facilities are associated with carbon neutral technologies. Higher rates of investment tax credit (3%, 6% and 12% for large companies, medium-scale companies and SMEs, respectively) apply to qualifying facility investment in these designated facilities.
- The interest rate on the refund of overpaid national taxes or customs duties and deemed rental income from rental deposit on real property is raised from 1.2% to 2.9% per annum, reflecting the recent upward trend in market interest rates.
- The growth rate of average wages in SMEs which serves as the basis for applying the tax credit for corporate payroll increase is adjusted from 3.0% to 3.2%. The tax credit for payroll increase allows SMEs to subtract from their income tax payable for the relevant year an amount equal to 20% (10% for medium-scale companies) of the excess incremental amount in average corporate payroll over a certain base level calculated in a prescribed manner by taking into account the average growth rate in corporate payroll during the previous three years.

MOTIE Announces the Government's Core Mineral Resources Strategy

The Ministry of Trade, Industry and Energy (MOTIE) announced on February 27, 2023 the government's core mineral resources strategy that includes the reintroduction of the tax credits for investments in overseas natural resources developments which sunset in 2013. The government plans to adopt again in 2023 the investment tax credit* aimed at facilitating the development of overseas natural resources (*tax incentives for investment in mining rights). The plan also calls for expanding the scope of deductible expenses incurred to develop natural resources and relieving the tax burden on dividends received from overseas subsidiaries relevant to the resources development in case of failed projects in resources development. In addition, the government is considering adding core minerals recycling technologies to the existing list of new growth and source technologies so that qualifying facility investments and expenditure associated with research and development in these technology sectors would be eligible for higher rates of tax credits.

National Tax Service and Korea Customs Service Sign a Memorandum of Understanding to Support SME Exporters

The National Tax Service (NTS) and the Korea Customs Service (KCS) signed a memorandum of understanding (MOU) for close cooperation to support SME exporters. Through the MOU, the NTS and the KCS seek to provide necessary tax administration support for compliant taxpayers and job-creating companies, etc. In this regard, the NTS has selected more than 8,000 SME exporters which should benefit from the KCS support in addition to the currently available benefits provided by the NTS. The available KCS support includes the extension of customs payment due dates, exemption from the security requirement for duty payments, special support for value added tax or duty refund for export, exclusion from the target selection for customs audits and the suspension of customs audits. In addition, the KCS selected approximately 2,400 SME exporters including those certified as authorized economic operators (AEO). Benefits made available by the NTS include the extension of due dates for national tax payments, exemption from the security requirement for tax payments, early refund of overpaid tax, exclusion from the target selection for regular NTS audits, the suspension of tax investigations and prioritized advance review of filed applications for R&D tax credits. The MOU shall become effective for two years from February 24, 2023 through December 31, 2025. The term of the MOU can be extended through the agreement between the NTS and the KCS.

Rulings Update

Timing of a deduction of bad debt expenses which had been disallowed in prior year but were not reversed and deducted in the year the reason for deduction occurred

Under the Corporate Income Tax Law (CITL), bad debt expenses can be deductible for tax purposes under either of the following cases: 1) where the company makes a tax adjustment for a deduction of the bad debt expenses on its income tax return in the fiscal year when its legal right to claim the receivable has been extinguished on the basis of any of the prescribed reasons such as the lapse of the statute of limitation for the receivable, etc. (the 'reason for tax deduction of bad debts not subject to write off per book') even if it does not write off the receivable on its book; or 2) where the company deducts the bad debt expenses through the write-off of the receivable on its book which has been determined to be non-recoverable based on any of the other prescribed reasons such as the debtor's bankruptcy or closing of business, etc. (the 'said reason for tax deduction of bad debts subject to write off per book' or the 'said reason') (Article 19-2(1) and (3) of the Presidential Decree of the CITL).

Meanwhile, where a company did write off the receivable on its book before the said reason occurs and disallowed the bad debt written off as non-deductible on its tax return, later if the company fails to reverse and deduct the previously disallowed bad debt on its tax return for the fiscal year when the said reason occurs, an issue may arise as to whether the company should submit an amended tax return to claim a tax deduction of the bad debt expense for the fiscal year in which the said reason occurs or whether it would be allowed to deduct the previously disallowed bad debt on a tax return for a fiscal year following the fiscal year in which the said reason occurs.

Regarding this issue, a recent advance tax ruling replied that the company in question may deduct the previously disallowed bad debt through a tax adjustment on its tax return for a fiscal year following the fiscal year in which the said reason occurs. (*Advance Ruling-2022-Beobgyubeobin-0633, 2023.1.9*). The recent ruling seems to have taken into account the existing authoritative interpretations providing that in case of the failure to deduct the bad debt expense in the year when the said reason occurred, the company cannot submit an amended tax return for deduction of the bad debt expense for the fiscal year when the said reason occurred on the grounds that: i) the disallowance of the bad debt expense recorded per book in the fiscal year before the said reason occurred can be merely considered as a deferral of tax deduction of the expense by disallowing the write-off of the receivable arbitrarily made by the company, and ii) the concerned receivable was not written off in the fiscal year when the said reason occurred. (*Corporation Tax Bureau of the Ministry of Economy and Finance-400, 2009. 5. 7, Joshim2017joong 3715, 2018. 2. 2. etc*.).

In addition, the recent ruling indicates that, the previously disallowed bad debt expense does not necessarily need to be deducted in the same year in which the said reason occurs, rather it can be deducted in any of the fiscal years following in which the said reason occurs as long as the statute of limitation for the concerned bad debt does not lapse. (*Advance Ruing-2021-Beobryeonghaeseokbeobin-1710, 2021. 11. 30*.). As such, it may be necessary to refer to the recent advance tax ruling in reviewing as to when bad debt expenses could be deductible in case the company had disallowed the bad debt expenses recorded per book before the said reason occurred but did not deduct the disallowed expenses on the tax return for the year when the said reason occurred .

Whether the company's payments for capital gains and acquisition taxes imposed to the owners of memberships returned would fall under entertainment expenses

If a company spends expenses for purposes of entertainment, relationship or compensation or any other similar purposes to facilitate a business with a transaction party, the expenses may fall under 'entertainment expenses', which is subject to a tax deduction limit of entertainment expenses, for corporate income tax purposes. On the other hand, the expenses may constitute sales related expenses, which are fully deductible, for corporate income tax purposes if the nature and amount, etc. of such expenses are regarded as ordinary expenses being directly related to the sale of goods or products in light of social norms or commercial practices. (*Deabeop200du 10389, 2009. 7. 9., Daebeop2005du 8924, 2007. 10. 25., etc*.).

This case deals with an inquiry raised by a company carrying on a condominium business to the tax treatment of certain expenditure incurred by the company to compensate a portion of capital gains or acquisition taxes imposed to the owners of condo memberships in the course of returning their condo memberships to the company for the purpose of rehabilitating its business through the reconstruction of obsolete condo facilities. The inquiry focuses on whether expenditure incurred by the company to compensate a portion of capital gains or acquisition tax liability of membership owners would constitute entertainment expenses or sales-related expenses of the company.

Regarding this, an authoritative interpretation of the NTS provides that where a company operating a condominium business plans to remove obsolete condo facilities to build new ones in a bid to solve a sharp decline in condo memberships as well as revenue and an increase in cumulative losses and, as part of the plan, undertakes to obtain the required consent of membership owners for the planned reconstruction of condos under the Act on Ownership and Management of Condominium Buildings, thereby enabling the memberships to be transferred, returned or sold in exchange for a new condo, the expenditure incurred by the company to compensate a portion of capital gains or acquisition tax liability of membership owners arising from the transfer, sale or exchange of condos should be treated as sales related expenses, rather than entertainment expenses, and be included in the company’s deductible expenses. (*Seomyeon-2022-beobin-4417, 2022. 12. 6.).*

It is deemed that the interpretation has been made, considering the following points: i) the compensation for capital gains tax, etc. is considered an inevitable expenditure necessary for the company to obtain the consent of membership owners which is a prerequisite for the reconstruction aimed at normalizing the operation of condominium business; ii) there are many court decisions indicating that, even if a taxpayer spends money owed by its transaction party in lieu of the party, it cannot be regarded as entertainment expenses if it is determined the spending is not aimed at facilitating a business relationship with the transaction party (*Daebeop 2010du 14329, 2012. 9. 27, Daebeop 2007du 12422, 2009. 11. 12. etc.*); iii) if expenses were spent voluntarily without any arrangement or agreement in advance of the expenditure or spent for a limited scope of customers, the expenditure can be regarded as entertainment expenses (*Seomyeon Internet Consulting Team 2 - 1019, 2005. 7. 6, Corporate Tax Division - 3460, 2008. 11 19., etc*.); and iv) it is difficult to regard it as financial support in the nature of entertainment expenses if a company compensated a portion of the said capital gains tax, etc. to regain an unspecified number of condo memberships according to a prearrangement.

Therefore, where a company would provide an unspecified number of transaction parties with goods or money based on a prearrangement or pay a portion of money or goods owed by a transaction party in lieu of the party as part of its efforts to normalize its business operation and solve problems of sales declines and suffering business, it may be necessary to consider this authoritative interpretation, etc. when reviewing an opportunity to apply the provision on the sales related expenses. It should be noted, however, that determining whether it would be entertainment expenses or sales related expenses might be a controversial issue in terms of legislative interpretation depending on the relevant facts and circumstances. Given this, it is recommended that a company confirms that certain expenditure could be treated as sales related expenses to be included in deductible expenses by seeking an authoritative interpretation or an advance ruling of the tax authorities.

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