



# Korean Tax Update Samil Commentary

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## Tax News

### Amended Presidential Decrees of Tax Laws are Proclaimed with a Few Modifications

After a series of tax law amendments, the Presidential Decrees of Tax Laws were officially proclaimed on February 29, 2024. These decrees include several modifications to the initially proposed amendments. Provided below are selected modifications.

- **Eased criteria for deduction for family business succession in Special Opportunity Zones:** The deduction for family business succession in special opportunity zones was initially proposed under two conditions: i) the inherited business premises must be entirely relocated to a special opportunity zone; or ii) the company inheriting a family business whose entire business premises are located within a special opportunity zone. However, easing these requirements, the modified amendment extends the deduction to cases where both the head office and main office of the company inheriting a family business are either relocated to, or situated within, a special opportunity zone, and the number of full-time workers at the premises located within a special opportunity zone is 50% or more of the total workforce.
- **Public charges treated as non-deductible expenses:** According to the Corporate Income Tax Law (CITL), public charges imposed as sanctions for non-performance of duties, or a violation of any of statutory prohibitions or restrictions shall not be considered as deductible expenses. It was initially proposed to include charges related to non-compliance with the obligation to employ persons with disabilities in the scope of non-deductible expenses. However, the initial proposal has been cancelled, leaving the current provision unchanged.
- **Clarification of VAT-exempt supply of personal services:** Article 42 (2) of the Presidential Decree of the VAT Law provides the scope of personal services exempt from value added tax (VAT). They include personal services rendered by individuals, corporations, unincorporated associations, foundations, or other organizations in their independent capacity, in return for the consideration paid. The initial proposal has been modified to clarify the scope of VAT-exempt personal services. Specifically, the following services are now included: i) manpower supply services where an employee works for another company under a manpower supply contract; and ii) simple manpower supply services where employees work at a third-party's business premises using the third-party's facilities or equipment, performing tasks such as manufacturing products. However, the modified amendment excludes temporary work agency services governed by the Law on the Protection of Temporary Agency Workers. The primary goal of the amendment is to promote fairness, aligning with similar industries such as services provided by job placement agencies. Additionally, it aims to enhance labor market flexibility. The amendment will apply to services provided on or after January 1, 2025.

## MOEF Announces Proposed Amendments to Enforcement Rules of Tax Laws

The Ministry of Economy and Finance (MOEF) has announced a bill to amend the Enforcement Rules of Tax Laws, following recent changes to a series of Presidential Decrees related to tax laws. Notably, the bill seeks to expand the range of facilities to commercialize national strategic technologies and new-growth and core technologies that are eligible for greater tax credits. Provided below are key points contained in the bill.

- Increase the interest rate applicable to national tax refunds and calculation of deemed rent for rental deposits as well as the standard interest rate for housing rental loans (from 2.9% to 3.5% per annum)
- Create procedures for confirming small new housing and unsold units of housing after construction in non-metropolitan areas, which are excluded from the scope subject to higher rates of capital gains tax and comprehensive property holding tax
- Provide specific guidelines for affixing corporate license plates to company vehicles to be entitled to deductions in relation to company car expenses
- Define the scope of land development projects eligible for the application of the work-in progress method in calculating taxable income to be included for each fiscal year with respect to the sales proceeds from the partial transfer of land prior to the project completion.
- Specify shares that can be excluded from the total number of outstanding shares in determining whether a relevant domestic company is a wholly owned subsidiary whose profits or losses may not be allocated for the computation of consolidated tax
- Adjust the useful life of molds to align with asset-specific standards (instead of industry-specific standards), i.e. applying 5 years of useful life to tools, instruments, fixtures, and molds
- Expand the range of facilities to commercialize national strategic technologies eligible for the integrated investment tax credit. This expansion includes the addition of four categories of facilities in the display and hydrogen sectors, as well as the expanded scope of an existing category of facilities in the semiconductor sector.
- Expand the scope of new growth commercialization facilities for the integrated investment tax credit. Specifically, the amended provisions would add 7 new facilities in the defense industry sector, etc. and expand the scope of 4 existing facilities.
- Extend the application of the existing research and development (R&D) tax credit to overseas testing on a consignment or re-consignment basis for non-clinical and clinical trials of national strategic technologies (phases 1, 2, and 3) in the biopharmaceutical sector
- Define the scope of business assets subject to a cap on the amount of tax exemption or reduction for startups operating within special opportunity zones
- Specify detailed provisions including the scope of film making expenses for additional tax credit related to video content production costs
- Define key terms related to the introduction of Global Anti-base Erosion (GloBE) rules, including the entities subject to the rules, and adjustment methods for accounting net

profit or loss and income inclusion ratio calculation methods, etc.

## Government Announces Corporate Value-Up Program with Preferential Access to Tax Benefits

On February 26, the government announced a plan to implement the Corporate Value-Up Program, designed to enhance the corporate value of listed companies. This initiative encourages voluntary participation by granting preferential access to existing tax benefits. Under the plan, the government will establish guidelines to assist companies with disclosing their strategies and plans for boosting corporate values. To incentivize the participation of listed companies, the government will provide various tax-related measures. The measures envisaged include exemption from audit target selection examination for companies with good compliance records and access to a preliminary review for applicable R&D tax credits; expedited processes for a refund request of VAT and corporate income tax and consulting for family business succession.

# Changes in Tax Laws

## Amended Presidential Decree of the Corporate Income Tax Law

### Background of Amendment

Subsequent to the amendment of the CITL that excludes a distribution through a reduction of capital surplus, such as a revaluation reserve out of merger gains of the domestic dissolving company, from the scope of taxable income of the domestic shareholder company, the amended Decree sets a limit on the excluded income amount in respect of the distribution made through capital surplus reduction out of merger gains. Also, as the amended CITL establishes the basis for allocation and settlement of profits and losses related to losses transferred between consolidated corporations, the amended Decree sets forth delegated details for its implementation. To better support essential businesses and non-profit corporations, the amended Decree expands the scope of entities not subject to the loss carryforward limitations to include schools, hospitals, etc. Additionally, the scope of deductible expenses has been expanded and clarified, aiming to support business management activities and foster family-friendly culture. Under the amended Decree, measures are introduced to streamline the taxation process for land development projects and put in place special treatment for land sale proceeds that will be included as taxable income. These amendments are designed to improve and supplement the existing system. (Proclaimed and implemented on February 29, 2024)

## Amended Presidential Decree of the Individual Income Tax Law

### Background of Amendment

In response to low fertility rates in Korea, recent amendments to the law seek to reinforce tax breaks for childbirth and childcare. Private school office staff are now eligible for the same tax treatment as public officials, exempting them from income tax on childcare leave allowances. The amended Decree stipulates the scope of non-taxable childcare leave allowances and other necessary provisions. To alleviate the tax burden on small sole proprietorships, the Decree expands the deductible scope of their business expenses. Additionally, it relaxes income deduction requirements concerning interest expenses on reverse mortgage loans. This measure is intended to provide financial relief for senior citizens. Furthermore, to stimulate growth in the construction industry and promote stability in the housing market, the temporary suspension of higher capital gains tax rates targeting those owning multiple houses is extended. (Proclaimed and implemented on February 29, 2024)

## Amended Presidential Decree of the Special Tax Treatment Control Law

### Background of Amendment

To enhance the competitiveness of the content industry, the amended Decree sets forth eligibility criteria for additional tax credits in relation to expenditure incurred for filming or video content production in line with the amended law. To foster balanced economic growth and incentivize investment in regional areas, the amended law offers corporate income tax exemptions or reductions for companies starting operations in designated special opportunity zones. The amended Decree specifies the eligible businesses, focusing on the manufacturing sector, that can benefit from tax reductions or exemptions within these zones while addressing delegated matters and implementation necessities. In a bid to bolster support for high-tech strategic industries and emerging growth sectors, the amended Decree expands the scope of new growth technologies and national strategic technologies eligible for the existing tax credits aimed at research and personnel development expenses. Moreover, to encourage corporate employment, the amended Decree improves the method for calculating the number of full-time employees in relation to the application of the integrated employment tax credit. (Proclaimed and implemented on February 29, 2024)

## Amended Presidential Decree of the VAT Law

### Background of Amendment

To alleviate the tax burden of small sole proprietorships, the amended Decree specifies detailed provisions, including the reinstatement of simplified taxation applicable even before the end of the taxable period in which the 3<sup>rd</sup> anniversary falls after the simplified taxation waived, irrespective of whether the taxpayer initiated a new business upon waiving the application of simplified taxation. In a bid to support housing and livelihoods of underprivileged individuals, the amended Decree exempts them from VAT on land rent for leased properties. Furthermore, it broadens the scope of VAT-exempt medical and healthcare services commissioned by both central and local governments. (Proclaimed and implemented on February 29, 2024)

## Amended Presidential Decree of the Inheritance and Gift Tax Law

### Background of Amendment

The amended law introduces a deduction for gifted property, aiming to ease the burden of gift tax on funds received upon marriage or childbirth. In this respect, it is deemed under the amended Decree as if no taxable gift had been made if gifts received before marriage are returned due to unavoidable circumstances such as the death of a fiancé or fiancée. To promote balanced regional development, the amended Decree loosens the follow-up management standards to continue claiming deductions for family business succession, specifically when a company relocates to a special opportunity zone following inheritance. Additionally, when assessing whether public interest corporations spend the mandatory percentage of expenditure from contributed funds for their public interest purpose business, it can be calculated based on the average expenditure over the past five fiscal years. (Proclaimed and implemented on February 29, 2024)

## Amended Presidential Decree of the Law for Coordination of International Tax Affairs

### Background of Amendment

To enhance control over overseas revenue sources, the amended law mandates residents and domestic corporations to submit required information regarding offshore trusts. The amended Decree provides further specifics of this new reporting requirement, including methods to determine the value of offshore trust property subject to reporting. In anticipation of the implementation of the GloBE Rules, the law has been amended to incorporate key elements outlined in the Administrative Guidance on the GloBE rules released by the OECD/G20 Inclusive Framework (IF). In alignment with this recent amendment, the amended Decree stipulates requirements for exemption of top-up tax paid under Qualified Domestic Minimum Top-up Tax (“QDMTT”) of other jurisdictions. Additionally, following the amendment aimed at refining exceptions to the application of CFC rules for foreign holding companies, the amended Decree rationalizes criteria pertaining to the percentage rate of the passive income, such as interest and dividend income earned by CFCs from their subsidiaries. (Proclaimed and implemented on February 29, 2024)

## Amended Presidential Decree of the Customs Act

### Background on Amendment

The amended Decree addresses recent changes to the Customs Act by specifying delegated details. These include establishing procedures for investigating circumvention dumping, implementing a new framework that enables taxpayers to request customs authorities to transmit tax information securely, determining compensation amounts for losses resulting from inspection of goods by customs officers, and defining central government agencies authorized to seek information related to drug smuggling. Moreover, it adds the causes for withholding customs clearance of goods. These amendments aim to fill the gap in the existing system. (Proclaimed and implemented on February 29, 2024)

## Amended Enforcement Rules of the Special Treatment Control Law for Local Taxes

### Background of Amendment

The amended Decree provides specific guidelines in response to recent amendments to the Special Treatment Control Law for Local Taxes. Furthermore, the amended Decree sets forth the requirements that the companies relocating their head offices, principal offices, or factories to special opportunity zones should satisfy in order to claim reductions in or exemption from local taxes, including acquisition tax. Additionally, companies establishing new factories within these zones will also enjoy local tax benefits. (Proclaimed and implemented on February 29, 2024)

9. Law for Liquor Licenses, etc. (Proclaimed and implemented on February 13, 2024)

10. Presidential Decree of the Basic National Tax Law (Proclaimed and implemented on February 29, 2024)

11. Presidential Decree of the National Tax Collection Law (Proclaimed and implemented on February 29, 2024)

12. Presidential Decree of the Comprehensive Real Estate Holding Tax Law (Proclaimed and implemented on February 29, 2024)



13. Presidential Decree of the Stamp Tax Law (Proclaimed and implemented on February 29, 2024)
14. Presidential Decree of the Individual Consumption Tax Law (Proclaimed and implemented on February 29, 2024)
15. Presidential Decree of the Liquor Tax Law (Proclaimed and implemented on February 29, 2024)
16. Presidential Decree of the Education Tax Law (Proclaimed and implemented on February 29, 2024)
17. Presidential Decree of the Special Tax for Rural Development Law (Proclaimed and implemented on February 29, 2024)
18. Presidential Decree of the Transportation, Energy and Environment Tax Law (Proclaimed and implemented on February 29, 2024)
19. Special Regulations regarding the Application of Zero rate VAT and Exemption from VAT for Equipment and Petroleum Products for Agriculture, Livestock, Forestry, and Fishing Industry (Proclaimed and implemented on February 29, 2024)
20. Presidential Decree concerning the Special Treatment of the Customs Law for the Implementation of Free Trade Agreements (Proclaimed and implemented on February 29, 2024)
21. Regulations on Tariff Concessions in accordance with the World Trade Organization Agreement (Proclaimed and implemented on February 29, 2024)



## Rulings Update

### Whether a foreign tax credit would apply to income tax withheld by China on fees for payment guarantee provided by a domestic company to a Chinese company

Under Articles 11 (1) and (2) of the Korea-China income tax treaty, interest income is generally subject to taxation in the country of the recipient. However, such interest may also be taxed in the country where it arises according to the laws of that country, but if the recipient is the beneficial owner of the interest, the tax charged should not exceed 10% of the gross amount of interest. On the other hand, other income shall be taxable only in the country of the recipient, as stipulated by Article 22(1) of the treaty. This case concerns the payment guarantee fees paid by a Chinese company to a domestic company for a payment guarantee provided by the domestic company. The Chinese company treated these fees as interest income on which China has taxing rights according to Article 11 of the Korea-China tax treaty and withheld and paid a 10% income tax on these fees to the Chinese tax authorities. The question arose as to whether the concerned withholding tax would be eligible for a foreign tax credit in Korea.

Regarding this, the Seoul High Court considered the following aspects among others: i) it would be reasonable to determine whether to allow a foreign tax credit in Korea based on the reasonableness of the foreign government's taxation and the resulting tax payment by the domestic company in the foreign country; ii) the Korean and Chinese tax authorities have differing views on whether payment guarantee fees are classified as interest income or not based on the different interpretations of relevant provisions of the Korea-China tax treaty; iii) given that the domestic company was compelled to bear the withholding tax liability on interest income for the payment guarantee fees in China due to the interpretation of Chinese tax authorities, it is difficult to view the withholding tax payment in China as lacking reasonableness. Considering the above, the High Court decided in favor of the taxpayer that the foreign tax credit should be allowed in this case. (*Seoul High Court 2019nu53770, 2020. 12. 18.*)

However, the Supreme Court decided against the taxpayer, stating that: i) the foreign tax credit applies to the amount of tax paid or payable in China to the extent that the source country's taxing right for the income is recognized under the Korea-China tax treaty; ii) if a certain amount of tax paid in China exceeds the extent of the Chinese taxing rights, it cannot be considered eligible for the foreign tax credit; iii) payment guarantee fees do not fall within 'interest income' under Article 11 of the Korea-China income tax treaty since the fees are paid as a consideration for the provision of payment guarantee, rather than a consideration for the provision of loans, by the domestic company; iv) and as such, unless payment guarantee fees fall into other specific items of income under other articles of the Korea-China tax treaty, the fees would constitute 'other income' for which the taxation rights are held only in Korea, and in this case, the concerned withholding tax on the fees paid in China would not be eligible for the foreign tax credit in Korea. Therefore, the Supreme Court overturned the lower court's decision and remanded the case to

the Seoul High Court. (*Daebeop2021du32248, 2024. 2. 8.*).

**Observation:** This Supreme Court ruling clarifies that foreign tax credits cannot be applied solely on the basis that the tax payment was made according to the determination of the tax authorities of China where the income arose. Rather, foreign tax credits should apply to the tax amount paid in the source country only to the extent that the source country's taxing rights are allowed under an applicable tax treaty, and any excess amount of tax paid over the source country's taxing rights under the applicable tax treaty would not be eligible for a foreign tax credit. Therefore, in order to claim foreign tax credits, it is necessary to ensure that the procedures are carefully taken for verifying whether the tax paid in a foreign country falls within the taxing rights of the source country under an applicable tax treaty between Korea and the source country of income.

### Whether the redemption amount exceeding the issue price of redeemable convertible preferred shares would be treated as a deductible expense

Article 19(1) of the Corporate Income Tax Law (CITL) provides that deductible expenses are losses or expenses resulting from transactions which reduce a company's net assets, excluding losses from capital transactions such as return of capital or appropriation of capital surpluses or earnings, unless otherwise stipulated under tax laws. This case pertains to the redemption of redeemable convertible preferred shares (RCPS), where the redemption amount exceeds the issue price. A key question focuses on whether the excess amount would be treated as interest expense, which is deductible and reduces the taxable income of the company redeeming RCPS, or as return of capital which is non-deductible for corporate income tax purposes.

The taxpayer claimed that the excess amount paid over the issue price of RCPS should be treated as interest expense, representing the consideration paid for the use of money. The grounds for the taxpayer's argument include that: i) neither the CITL nor the Commercial Code provide distinct criteria for distinguishing between capital and liabilities. Therefore, whether a transaction falls under either capital transaction or profit or loss transaction (relating to liabilities) should be determined based on the substance of the transaction; ii) since the redemption amount of RCPS is calculated based on an explicit repayment period and an annual interest rate while RCPS has no voting rights, the issue price of RCPS should be in substance considered as a liability; and iii) the taxpayer has also accounted for the issue price of RCPS as a liability in accordance with the K-IFRS.

However, the Tax Tribunal decided that it is difficult to regard the excess amount as interest expense based on the grounds that: i) RCPS may fall within the shares under the Commercial Code, in that RCPS, which is a type of share that grants both the redemption rights and conversion rights, is issued in accordance with the procedures for issuing new shares and typically retired through a normal capital reduction procedures; ii) RCPS have the character of capital from an economic perspective as investors can exercise the rights to convert RCPS into common stock at any time during a given conversion period and have the rights to receive dividends; and iii) unlike the K-IFRS, the Korean Generally Accepted Accounting Principles (K-GAAP) classify RCPS as capital, and it would be contrary to the fair taxation if the tax burden varies depending on the accounting treatments on RCPS taken by the companies. (*Joshim2022seo7678, 2023. 12. 22.*).

**Observation:** The Tribunal has consistently taken the position that even if RCPS are recognized as a liability in accordance with K-IFRS for accounting purposes, it should be reasonable to treat RCPS as capital (i.e., shares) for corporate income tax purposes (*Joshim2019seo3882, 2020.4.26, etc.*). Therefore, it is important to note that there may be discrepancies in the treatment of RCPS between financial accounting and tax accounting. Furthermore, there exists a precedent case where gift tax considerations were made by treating RCPS as shares when applying the tax provision for gift of profits arising from capital increases under the Inheritance and Gift Tax Law (*Joshim2021gwang2339, 2021. 8. 11.*). Therefore, it appears necessary to consider this precedent case, along with the Tribunal's judgment.

### Whether a youth startup SME relocating to a non-metropolitan area would claim a higher rate of tax reduction for the remaining reduction period

The Special Tax Treatment Control Law (STTCL) primarily provides a 50% tax reduction for small and midsize enterprises (SMEs) that are established and start their business in regions outside designated metropolitan areas during the tax reduction period (generally for five tax years from the tax year in which income is first generated from the business after establishment). In order to support youth start-ups, the 50% tax reduction applies for a youth startup SME even if it is established and starts a business in a metropolitan area. Additionally, the reduction rate is elevated to 100% for a youth startup SME being established and starting a business outside metropolitan areas (as per Article 6(1) of the STTCL). This case pertains to a youth startup SME relocating its business premises from a metropolitan area to a non-metropolitan area. The question focuses on whether the 100% tax exemption (instead of the 50% reduction) can be applied for the remaining reduction period from the tax year when the relocation occurs by treating as if the youth startup SME had been established and started its business outside metropolitan areas.

In this ruling, the Tax Tribunal clarified that the tax reduction rate for youth startup SMEs should be determined based on the location where the startup is established and started the business. Notably, there is no separate tax provision addressing the case where the business premise is relocated from a metropolitan area to a non-metropolitan area after the startup was established and started a business. Considering the above, the Tribunal concluded that even if a youth startup SME, which was established and started its business in a metropolitan area, subsequently relocates its business premises to a non-metropolitan area, the reduction rate cannot be increased from 50% to 100% for the remaining reduction period. (*Joshim2023bu7255, 2024. 1. 24.*)

**Observation:** This ruling indicates that the tax reduction rate for youth startup SMEs is determined based on the business location at the time of establishment. Therefore, the reduction rate cannot be increased for the remaining reduction period solely because a youth startup SME, established in a metropolitan area, subsequently relocates its business outside the metropolitan region. Conversely, if a youth startup SME, established and started a business outside a metropolitan area, relocates to a metropolitan area, the 100% tax reduction rate initially applied based on the location of business commencement will no longer apply.

Instead, the tax reduction rate will be reduced from 100% to 50% for the remaining reduction period, as stipulated in Article 5(25) of the Presidential Decree of the STTCL. It is necessary to note that there are separate regulations that address rate reductions in such opposite circumstances.

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.

# Contacts

## Robert Browell

+82-2-709-8896  
robert.browell@pwc.com

## Kyoung Soon Lee

+82-2-3781-9982  
kyoungsoon.lee@pwc.com

## Han-Chul Cho

+82-2-3781-2577  
han-chul.cho@pwc.com

## Jae-Hoon Jung

+82-2-709-0296  
jae-hoon\_3.jung@pwc.com

## Tae-Hoon Kim

+82-2-3781-2348  
taehoon.kim@pwc.com

## Seong-Deok Kong

+82-2-709-7056  
seongdeok.kong@pwc.com

## Young-Hyun Jo

+82-2-3781-9238  
young-hyun.jo@pwc.com

## Min-Jae Lee

+82-2-709-8320  
min-jae\_1.lee@pwc.com

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