September 15, 2023

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Government Finalizes Its Tax Reform Proposals for 2023

The government has finalized the tax reform proposals for 2023 which were released on July 27 and submitted to the National Assembly on September 1, 2023. One of the noteworthy modifications included in the finalized proposals is the removal of an initially proposed change aimed at reducing the timeframe for submitting local and master files. In a bid to bolster the taxation on international transactions, an initial proposal was made to mandate companies to submit these files within six months (rather than 12 months as present) from the end of their fiscal years.

MOEF Announces the Budget Bill for 2024 and Submits the National Tax Expenditure Plan for 2024

The MOEF announced the budget bill for the fiscal year 2024. According to this budget proposal, the national tax revenue is anticipated to amount to KRW367.4 trillion, marking a significant reduction of KRW33.1 trillion compared to the 2023 budget of KRW400.5 trillion. The proposed revenue by major tax categories breaks down to: i) the revenue from individual income taxes would decrease by KRW6.0 trillion from the 2023 budget, primarily driven by a decline in capital gains tax revenue due to uncertainties in the capital market. The revenue from wage and salary tax is expected to experience a slight increase, reflecting growth in wages and employment; ii) the revenue from corporate income tax would decrease by KRW27.3 trillion from the 2023 budget due to a slowdown in corporate profit growth; and iii) the value added tax revenue is anticipated to rise compared to this year's

revenue forecast, driven by increased consumption, etc. However it is estimated to be KW1.8 trillion lower than the 2023 budget.

The MOEF also submitted the National Tax Expenditure Plan for 2024 to the National Assembly on September 1, 2023 as an attachment to the 2024 Budget Bill. According to this plan, national tax reliefs (i.e. non-taxation, tax exemptions, tax credits and income deductions) are predicted to be KRW69.5 trillion, an increase of KRW6.0 trillion from KRW63.5 trillion in 2022. The growth in tax exemptions and reductions can be primarily attributed to the expansion of research and development tax credits and increased income deductions for credit card expenditures. Consequently, the total amount of tax exemptions, etc. as a portion of the total national tax revenue ('exemption ratio') is anticipated to rise to 13.9% in 2023, up from 13.0% in 2022. However, it is expected to remain below the statutory threshold of 14.3% for tax exemptions. Also, the projected tax exemptions in 2024 stand at KRW77.1 trillion, marking a KRW7.6 trillion increase from 2023. This increase is driven by the reintroduction of temporary tax credits on specific facility investments, the expansion of child tax credits and other incentives to revitalize the economy. As a result, the exemption ratio is estimated to reach 16.3% in 2024, surpassing the statutory threshold of 14% by 2.3% points.

Large Corporations Experienced a Higher Effective Tax Rate than Middle Standing Enterprises and SMEs in 2021

According to the Ministry of Economy and Finance (MOEF), in 2021, large corporations experienced a higher effective tax rate (ETR) of 22.1% when factoring in foreign taxes paid, in contrast to middle standing enterprises and small and midsize enterprises (SMEs). The ETR of 22.1% on business income of large corporations (22.2% for certain large corporations subject to restrictions on cross-shareholdings) was a 0.3% point increase (0.5% point increase for those subject to cross-shareholding restrictions) from the previous year, and it is higher than the ETR of 20.1% for middle standing enterprises and 14.4% for SMEs. The Ministry explained that it is reasonable to include foreign taxes paid when assessing the tax liability on business income since the foreign tax credit is designed to deduct foreign taxes paid from domestic tax liabilities in order to prevent double taxation on the same income between Korea and other jurisdictions, and therefore is not viewed as a tax incentive. Meanwhile, the tax credits and exemptions* regarded as tax incentives amounted to KRW5 trillion for SMEs, compared to KRW4.1 trillion for large corporations. The total amount of tax credits and exemptions as a percentage of the total tax liabilities of SMEs stood at 24.5%, a considerable contrast to 6.3% for large corporations. (*When considering foreign tax credits deducted, the total amount of tax credits and exemptions reached KRW5.1 trillion for SMEs and KRW9.4 trillion for large corporations, respectively.)

Rulings Update

Whether corporate income tax should refer to the tax on income before a deduction of tax loss carryforward in calculating the net income value for the valuation of unlisted shares

Under the Inheritance and Gift Tax Law (IGTL), the value of unlisted shares is calculated based on the weighted average of the adjusted net income value and the adjusted net asset value according to the supplementary valuation method. In calculating the adjusted net income value, corporate income tax for a relevant fiscal year should be subtracted from the taxable income of the unlisted company for the fiscal year (*Article 54(4)(2)(1) of the old Presidential Decree of the IGTL, 'Article at issue'*). The issue in this case was whether the 'corporate income tax for a relevant fiscal year' should be interpreted as 'the tax on income after deducting tax losses carried forward' or 'the tax on income before deducting tax losses carried forward.'

According to Articles 13(1) and 55(1) of the Corporate Income Tax Law (CITL), corporate income tax for a fiscal year shall be calculated as the corporate income tax base after deducting tax losses carried forward, non-taxable income and applicable income deductions from the taxable income, multiplied by the prescribed corporate tax rate, for the fiscal year. Also, under the Article at issue, there is no provision for the recalculation of corporate income tax based on the income before deducting tax losses carried forward for the fiscal year in calculating the adjusted net income value. In this regard, there have been arguments that it is reasonable to interpret that the "corporate income tax for a relevant fiscal year" should be determined based on the income after deducting tax losses carried forward in calculating the adjusted net income value.

However, the Seoul High Court ruled that the 'corporate income tax for a relevant fiscal year', which is subtracted from the taxable income in calculating the adjusted net income value, should be determined based on the 'income before deducting tax losses carried forward', taking into consideration the following, among others: i) unless there is any explicit provision to apply the CITL provisions in this tax calculation under the IGTL, it is necessary to reasonably interpret the meaning of the "corporate tax for a relevant fiscal year" in accordance with the purpose of the legislation of the 'adjusted net income value' under the IGTL, rather than the corporate tax payable or paid based on the provisions of the CITL; ii) the term 'relevant' used in 'corporate income for the relevant fiscal year' relates to the most recent three years and, therefore, it would be reasonable to compute the adjusted net income value for a specific three-year period based on the profits or losses only for the recent three years, excluding any impact of tax losses carried over from any other prior years; and iii) if tax losses are carried forward for up to 10 prior years and are considered in calculating the adjusted net income value for the three-year period as stipulated in the IGTL, it would be difficult to accurately determine the share value as of the valuation date. The Seoul High Court's decision has been reaffirmed by the Supreme Court. *(Daebeop2019du 56838, 2023. 6. 29, Seoul High Court2019du 30920, 2019. 10. 2.)*

The recent decision has reconfirmed the previously established position that in the absence of an objective market value for unlisted shares, the adjusted net income value should be calculated to reflect the share value in a more accurate manner as of the valuation date in the course of valuating the share value according to the supplementary method under the IGTL. (*Daebeop2011du22280, 2013. 11. 14*.) Also, it is meaningful to note that this is the first ruling providing the clarification on

these disputes over the past years, stating that the 'corporate income tax for a relevant fiscal year', which is subtracted from the taxable income in calculating the adjusted net income value under the IGTL, should refer to the 'corporate tax on income before a deduction of tax losses carried forward'.

Hence, when performing a share valuation for an unlisted company having tax loss carryforward according to the supplementary method, special care must be taken not to calculate the adjusted net income value by subtracting the corporate income tax on the income after deducting tax losses carried forward for a relevant fiscal year in order to avoid overcalculating the adjusted net income value and share value under the IGTL.

Whether the ARET sum-up exclusion rule would apply to certain rental houses owned by a non-resident

According to Article 8(2) of the Aggregate Real Estate Tax ('ARET') Law, certain private rental houses and employee houses held by a taxpayer can be excluded from the scope of real estate subject to the ARET sum-up if they meet the requirements for the exclusion from the ARET sum-up outlined in Article 3 and 4 of the Presidential Decree of the Law ('the ARET sum-up exclusion rule'). To benefit from this exclusion from the ARET sum-up, the taxpayer must submit an exclusion report to the local tax office between September 16th and September 30th.

A recent authoritative interpretation issued by the National Tax Service (NTS) addresses an inquiry of whether the ARET sum-up exclusion rule can be applied to the rental house which was initially eligible for the ARET sum-up exclusion where the owner's status has changed from a resident to a non-resident of Korea after he or she is lawfully admitted for permanent residence in the US and left Korea. The NTS replied that a non-resident can benefit from the ARET sum-up exclusion rule in the same manner as a resident, provided that the rental house meets the criteria for the exclusion as of June 1st each year. (*Seomyeon-2022-Real Estate-4552, 2023. 3. 21.*).

Currently, the ARET Law provides an additional deduction (KRW300 million), as well as housing tax credits for an individual aged 60 or older and for an individual who has held the property for five years or longer, if the individual falls under a single house owner per household prescribed in the Presidential Decree of the ARET Law. For this purpose, the term 'single house owner per householder' is specifically limited to the resident of Korea who owns a single house subject to property tax (*Article 2-3 of the Presidential Decree of the ARET Law*). Consequently, it is important to note that nonresidents are only eligible for the ARET sum-up exclusion in relation to qualifying rental houses, whereas they do not qualify for the additional deduction and housing tax credits for senior and long-term house holders. (*Section 8-2 (3-5) of the guidance on the application of the ARET Law and Joshim 2009seo 1482, 2010.4.7., etc.*).

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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