Tax News Flash

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Government's Bill to Amend Presidential Decrees of Tax Laws

Following the amendment of tax laws at the end of December 2022, the Ministry of Economy and Finance (MOEF) announced the government's bill to amend the Presidential Decrees of these tax laws on January 18, 2023 to seek public comments thereon until February 3, 2023. The government's bill will be proclaimed in February 2023 after being finalized in the cabinet meeting. If approved, most of the proposed amendments to the Presidential Decrees will take effect from the date the amended rules are proclaimed or from the fiscal year in which the effective date falls, unless otherwise specified.

Provided below is a brief summary of the selected significant changes contained in the government's bill to amend the Presidential Decrees of the tax laws (the 'Bill').

Corporate Income Tax Law (CITL)

Scope of a dividend received deduction (DRD) for dividends from a foreign subsidiary

The recently amended CTIL introduces DRD rules for dividends received by a domestic company from its foreign subsidiary. Before the amendment, a domestic company had to include such dividends in its taxable income that were subject to normal corporate income tax rates and may claim foreign tax credits for foreign tax paid by the foreign subsidiary to the extent of a deduction limit. Under the amended CITL, the new DRD rules, rather than the foreign tax credit rules, will apply to dividends received by a domestic company from a qualifying foreign subsidiary. The DRD rate is 95% of the dividend received, or deemed to be received, by the domestic company. The Bill further specifies the foreign subsidiary shareholding requirement and the excluded scope for the new DRD rules as follows:

- In order to be eligible for the DRD rules, a domestic company should 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.
- The DRD rules would not apply to: i) dividends received from a foreign subsidiary* which engages in a passive business (leasing, etc.) or a business mainly for passive income (interest, dividends, etc.) and whose effective tax rate is 15% or less; or ii) dividends received from hybrid financial instrument** transactions if income from the hybrid financial instrument is treated as dividend income on equity in Korea but is treated as an interest payment on debt in a foreign jurisdiction. (**It refers to a foreign subsidiary whose undistributed earnings is subject to the Korean controlled foreign company (CFC) rules. **It refers to financial instruments that combine debt and equity feasures.*)

Eased criteria for foreign subsidiary eligibility for indirect foreign tax credits

Previously, the scope of qualifying foreign subsidiaries eligible for an indirect foreign tax credit was limited to those foreign subsidiaries where a domestic parent had been directly holding at least 25% of the shares or interest in the foreign subsidiary for at least six months prior to the dividend declaration date (i.e., the date on which dividend payment is approved at the shareholders' meeting) of the foreign subsidiary. Under the recently amended CITL, to be aligned with the foreign subsidiary shareholding requirement for the DRD, the 25% threshold has been lowered to 10%. Further, the Bill proposes that a qualifying foreign subsidiary eligible for an indirect foreign tax credit should refer to the subsidiary where a domestic parent has been directly holding at least 10% of the shares or interest in the foreign subsidiary for at least six months prior to the dividend record date.

Additional information requirements for an application of income tax treaty exemption

To claim withholding tax exemption under an applicable tax treaty, a non-resident or a foreign corporation which is a substantive owner of Korean source income is required to provide the payor of income with an application form for an income tax treaty exemption, together with a residence certificate issued by a competent authority. Under the Bill, if an income tax treaty exemption is applied to amounts of KRW 1 billion or more, a foreign corporation (excluding overseas investment vehicle) is required to provide additional information including: i) information on the incorporation of the foreign corporation (including an overview of board composition and shareholders, etc.); ii) business information of the foreign corporation (including auditor's reports submitted in the country of residence of a foreign corporation within the latest three years); and iii) in case of royalty income, documents that can prove the actual owner of the intangible assets, etc. (including license agreement, documents demonstrating the place of registration and owner of intangible assets). The requirement for additional information above would also apply where the total amount of treaty exemptions claimed by a foreign corporation for one year retroactively from the date of income payment is KRW 1 billion or more.

Details on purchaser-issued tax invoices

With effect from July 1, 2023, the amended CITL allows a purchaser (or a recipient) of goods or services to issue a tax invoice ('purchaser-issued tax invoice') if confirmed by a district tax office in case tax invoices are not issued by a supplier for the supply of VAT-exempt goods or services. With the introduction of the new rules for purchaser-issued tax invoices, the Bill proposes the following:

- (Target supply) It would apply to the supply price of KRW 50,000 or more per transaction
- (Procedures for issuance) i) An applicant (i.e., a purchaser) files a request for confirmation of supply with the head of the concerned tax office (the 'applicant's district tax office') within six months from the end of the fiscal year; 2) the head of the applicant's district tax office sends copies of the relevant documents to the head of the tax office having jurisdiction over the supplier (the 'supplier's district tax office') within seven days from the request filing date; 3) the head of the supplier's district tax office confirms the supply and notifies the confirmation by the end of the following month after the filing date; 4) following the confirmation, the applicant issues a purchaser-issued tax invoice.

Extended tax invoicing requirement for supply of goods or services to a foreign liaison office

The Bill proposes to extend the current tax invoicing requirement to liaison offices of foreign corporations to which VAT-exempt goods or services are supplied. Under the CITL, a supplier of VAT-exempt goods or services is required to issue a tax invoice to a person receiving the goods or services, with certain exemptions as specified in the Presidential Decree. The specified exemptions for tax invoicing requirements include a supply of VAT-exempt goods or services to a 'non-resident or a foreign corporation having no domestic place of business'. Under the Bill, a foreign liaison office will

be excluded from the scope of a 'nonresident or a foreign corporation having no domestic place of business' that is exempt from the tax invoicing. As such, a supplier should issue a tax invoice to a foreign liaison office for the supply of VAT-exempt goods or services to the foreign liaison office. This proposal is in line with a recent amendment to the CITL that requires foreign liaison offices to submit an aggregated summary of input tax invoices. The proposed change will apply to the supply of goods or services on or after July 1, 2023.

Law for Coordination of International Tax Affairs (LCITA)

Clarification for a deemed payment date of deemed dividends for transferred income

Under the LCITA, where a transfer pricing income adjustment has been treated as a temporary difference during a 90-day period until the income adjustment is repatriated by a foreign related party to a domestic corporation, the income adjustment not being repatriated by the foreign related party until the end of the 90-day period would be additionally treated as a deemed dividend to or an increase in equity contribution by the foreign related party, with some exceptions for the immediate imposition of a deemed dividend, etc. even before the 90-day period ends as specified in the Presidential Decree of the LCITA. In this case, currently, the deemed dividend is regarded as being paid to the foreign related party on the date a notice for transferred income (being treated as a deemed dividend) is received. The Bill clarifies that where the income adjustment (being treated as a deemed dividend) has been made by the relevant taxpayer, it would be deemed that the dividend is paid to the foreign related party on the date a tax return is filed or an amended tax return is filed, whereas, in the case of adjustment made by the tax authorities, it continues to be deemed that the dividend is paid on the date a notice of transferred income is received.

Exemption requirements for submission of international transaction documents

Taxpayers conducting cross-border transactions with overseas related parties are required to submit prescribed documents including a statement of international transactions, a summarised income statement of an overseas related party and a report on arm's length pricing methods. The Bill proposes new or additional conditions for the exemption from the document submission requirements as follows:

- (a statement of international transactions) the total amount of transactions of goods, services and intangible assets with overseas related parties is KRW 500 million, KRW 100 million and KRW 100 million or less, respectively;
- (a summarised income statement of an overseas related party), the total amount of transactions of intangible assets with overseas related parties is KRW 200 million or less in addition to the existing requirements for exemption; and
- (a report on arm's length pricing method) the total amount of intangible asset transactions with overseas related parties is KRW 1 billion or less (KRW 200 million or less or intangible transactions with each overseas related party) in addition to the existing requirements for exemption.

In addition, taxpayers are currently required to submit Master and Local Files if they meet the following conditions that: 1) sales in the relevant fiscal year exceed KRW 100 billion; and 2) the total amount of goods, services, and loan transactions with overseas related parties exceeds KRW 50 billion in the relevant fiscal year. It is proposed that the amount of intangible asset transactions would be counted in determining whether the total amount of transactions with overseas related party exceeds the KRW 50 billion threshold in 2).

Clarified requirements for submission of hybrid financial instrument transaction documents

Currently, a domestic corporation that engages in transactions of hybrid financial instruments specified in Article 57 of the Presidential Decree of the LCITA shall submit a statement of adjustment of interest expenses concerning hybrid financial instruments to a relevant tax office. The Bill specifies the target corporation, subject to the

submission requirement, as a domestic corporation whose interest paid to an overseas related party under hybrid financial instrument transactions is included in its taxable income. The documents to be submitted and the due date for submission remain unchanged. In other words, a statement of adjustments to interest expenses concerning hybrid financial instruments must be submitted by the filing due date of corporate income tax return for the relevant fiscal year.

New penalty for non-submission of transaction documents for hybrid financial instruments

For failure to comply with the submission requirement, a new penalty of up to KRW 30 million per instrument shall be imposed under the recently amended LCITA. The Bill proposes details of penalty imposition: In principle, the penalty would be imposed at KRW 20 million per instrument for failure to submit by the due date and KRW 10 million per instrument for false submission. As an exception, in consideration of the degree, frequency, reason and outcome of violations of the submission requirement, penalties would be reduced or increased by 50% with a cap at the value of maximum penalties. The penalty will apply to interest payment made from the fiscal year beginning on or after January 1, 2023.

Special Tax Treatment Control Law (STTCL)

Expanded scope of the new growth or source technology eligible for R&D tax credit

Currently, qualifying R&D expenditures for new growth or source technologies is eligible for R&D tax credits at rates higher than the credit rates available for other general technologies. The existing list of new growth or source technologies includes 260 kinds of technologies in 13 categories including future cars, next-generation software and intelligent information. The Bill proposes to add 12 kinds of technologies to the existing list eligible for a higher rate of R&D tax credit, including: intelligent cold chain monitoring technology, two kinds of small module reactor design, verification, and manufacturing technology, ultra-fine long fibre non-woven fabric and composite filter manufacturing technology and eight kinds of carbon neutral technology including liquefied hydrogen storage technology for liquid hydrogen carriers, etc.

Expanded scope of the national strategic industrial technology eligible for R&D tax credit

The STTCL provides for the highest rates of tax credit (that are 10% higher than the credit rates for new growth or source technologies) for qualifying R&D expenditures incurred for any national strategic industrial technologies prescribed in the Presidential Decree of the STTCL. The existing list of national strategic industrial technologies include 36 kinds of technologies in three industrial sectors (20 in semiconductors, nine in secondary battery, seven in vaccine). Under the Bill, two additional kinds of technologies in the semiconductor sector and five kinds of technologies in the display sector will be newly included in the list to benefit from the highest R&D tax credit. They include: (semiconductor) foundry IP design and verification technology as well as system semiconductor test technology; and (display) active organic light emitting diode (AMOLED), micro LED as well as QD (Quantum Dot) nano material display.

Expansion of "youth worker" age criteria

The age requirement to be considered a "youth worker" which currently ranges from 15 to 29 years will be expanded to be from 15 to 34 years. The expanded age requirement will apply to corporate income tax exemptions and reductions, etc. for high-technology companies located in nine categories of special zones including research and development (R&D) zone as specified in Articles 11-2(5), 61(6), 99-8(5), etc. of the Presidential Decree of the STTCL. The age requirement for corporate tax incentives for start-up SMEs and personal income tax reductions for employees hired in SMEs remains unchanged (i.e., between 15 and 34 years).

Details to implement the new integrated employment tax credit regime

The amended STTCL introduces an integrated employment tax credit regime which has replaced

five types of tax benefits aimed at encouraging employment and job creation. The Bill sets out details to implement the integrated employment tax credit regime as follows:

- **Applicable scope** includes most industries except consumption-oriented service businesses (for example, entertainment bars, hotels, etc.)
- **Scope of full-time employees** includes domestic workers who have signed employment contracts (excluding workers with less than one-year of employment contract term, part-time workers, executives, largest shareholders, etc.)
- **Scope of full-time employee for preferential tax credit treatment** includes youth worker aged between 15 and 34 (rather than 29 at present), workers aged 60 or more as of the date of employment contract, women with career interruptions, disabled, wounded, etc.

Accelerated depreciation for energy saving facilities

To provide tax incentives for investment in energy saving facilities, the Bill allows companies to accelerate the depreciation of energy-saving facilities (acquired in the period from January 1 through December 31, 2023) over their useful lives as elected and reported within the range of +/-50% (or +/-75% for SMEs or medium-scale companies) of the standard useful lives. The scope of energy facilities eligible for the accelerated depreciation is proposed to include: i) energy-efficient facilities under the Energy Use Rationalization Act; ii) wastewater reclamation and reusing system under the Act on Promotion and Support for Water Reuse as well as water-saving devices under the Waterworks Act; and iii) facilities for manufacturing parts, intermediate materials, or finished products of new energy and renewable energy production facilities in accordance with the New Energy and Renewable Energy Development, Use and Diffusion Promotion Act.

Value Added Tax Law (VATL)

VAT invoicing requirement extended to supply of goods or services to a foreign liaison office

The Bill proposes to extend the current VAT invoicing requirement to liaison offices of foreign corporations to which goods or services are supplied. Currently, a supplier of goods or services (excluding VAT-exempt goods or services) is required to issue VAT invoice to a person receiving the goods or services, with certain exemptions as specified in Article 71(1) of the Presidential Decree of the VATL. The specified exemptions from the VAT invoicing requirement include the case where goods or services are supplied to a 'non-resident or a foreign corporation having no domestic place of business'. In this context, however, the Bill specifically excludes a foreign liaison office from the scope of a 'non-resident or a foreign corporation having no domestic place of business' that are exempt from the VAT invoicing requirement. The proposed changes will apply from the goods or services supplied after July 1, 2023.

Specific cases for restrictions on the issuance of revised import VAT Invoices

Previously, a revised import VAT invoice could be issued to an importer where an importer filed a revised declaration knowing in advance that the tax base or the tax would be determined or corrected following a customs audit, etc. by the customs office on the condition that an error contained in the invoice is found to be caused by a mistake or minor negligence on the part of the importer or the importer proves that such error was not attributable to itself. The recently amended VATL eases restrictions on the issuance of revised import VAT invoices by replacing the positive list with a negative list system whereby revised import VAT invoices may be in principle issued unless there are specific reasons to restrict the issuance of revised import VAT invoice, as prescribed in the law. The Bill proposes restrictions on the issuance of revised import VAT invoices in the following cases where: 1) there is a recurring error which has been already notified through a customs audit in later customs declarations following the notification; 2) any action is not taken in respect of the erroneous information in the customs declaration which has been

provided in advance by the head of the customs office; 3) import-related transaction data and underlying tax data submitted at the time of declaring customs value are obviously different from the facts; and 4) failing to comply with the request for submitting tax data related to transactions with overseas related parties or submitting incorrect data.

Input VAT deduction for incorrect invoicing due to an error for sales discount vs. sales incentive

Currently, an input VAT deduction is allowed for special cases where VAT invoices are incorrectly issued due to an error in recognizing the type of transaction (e.g., treating a consignment sale of goods as a direct sale of goods or vice versa), provided that certain conditions specified under the VATL are satisfied. The Bill will expand the scope of such special cases to the case where a sales discount is mistakenly treated as a sales incentive or vice versa (but limited to the case where a revised VAT invoice is not issued). To qualify for input VAT deduction in those special cases, it should ensure that a VAT invoice is issued and VAT is duly paid in a manner in accordance with the type of transaction the transaction party has recognized.

Other Proposed Changes

Adjusted scope of the unlisted shares subject to the net asset value based share valuation

Under the Individual Income Tax Law (IITL), the value per share of unlisted shares is calculated based on the weighted average of adjusted net income per share and adjusted net asset value per share in ratio of 3 to 2. For shares of certain companies prescribed in the Presidential Decree of the IITL, however, the value of shares shall be calculated only based on the adjusted net asset value per share (the 'net asset value method') to ensure consistency with the valuation method under other law (i.e., Inheritance and Gift Tax Law, "IGTL"). In this regard, the Bill proposes that:

- The net asset value method would no longer be permitted for the valuation of shares in companies which have continued to incur losses during the most recent three fiscal years;
- The net asset value method would newly apply to shares in the following three additional types of companies: 1) real property-rich companies where real property accounts for 80% or more of its total assets; 2) companies where shares account for more than 80% of total assets; and 3) companies whose duration is fixed at the time of establishment and remaining duration is less than 3 years as of the valuation date.

Medium-scale company not subject to a control premium valuation for the largest shareholder

Under the IGTL, shares held by the 'largest shareholder and its related parties' (the 'largest shareholder') shall be calculated by adding a 20% premium to the share value of the company valuated in accordance with the IGTL ('control premium valuation') with some exceptions. Under the Bill, the control premium valuation would be waived for the valuation of shares issued by a medium-scale company under the Medium-scale Company Act, with average sales of less than KRW 500 billion for the most recent three years. Currently, it is waived for six kinds of cases, including where a company subject to a share valuation had tax losses consecutively for the most recent three years.

New regulations for customs clearance of e-commerce merchandises

The recently amended Customs Act includes a new provision which should provide a legal framework to obtain transactional data from platform providers, etc. with respect to electronic commerce businesses. The new rule allows the Commissioner of the Korea Customs Service (KCS) to request prescribed transaction information from buying agents, direct-mail businesses or mail-order brokers, etc. Under the Bill, the prescribed information would include ordering information and information on recipients of goods, etc. In addition, it requires the KCS to inform consumers of an order item name and an amount of duties to be paid at the time of customs clearance of e-commerce goods. The proposed change will apply to requests made on or after July 1, 2023.

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