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 2023, the Ministry of Economy and Finance (MOEF) announced the government's bill to amend the Presidential Decrees of these tax laws on January 23, 2024 to seek public comments thereon until February 14, 2024. The government's bill will be proclaimed at the end of February 2024 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)

Excluded scope of deemed dividends not subject to corporate income tax from the DRD rules

Under the CITL, in general, dividends eligible for a dividend received deduction (DRD) include profit or earning distributions or deemed dividends which are deemed as dividends for tax purposes. However, the DRD rules shall not apply to prescribed categories of dividends including dividends received from a company which is entitled to the non-taxation, exemption, or reduction of corporate income tax. Under the recently amended CITL, the DRD rules shall not apply to additional categories of dividends that include i) dividends received by reducing a certain percentage of revaluation reserve (including a certain amount of gains transferred from gains on a merger or spin-off) and ii) deemed dividends which are not subject to corporate income tax such as an excess amount of the distributed value over the acquisition cost of the shares through capital reduction, etc. as prescribed in the Presidential Decree of the CITL. The Bill further proposes that the excluded scope of deemed dividends for the DRD rules in ii) shall include: a) deemed dividends received pursuant to capital reduction with consideration (i.e., consideration distributed to shareholders through capital reduction in excess of the acquisition cost of shares); and b) deemed dividends arising from the conversion of capital surplus into capital by a company owning treasury stock. Designed to relieve double taxation and prevent tax avoidance, the proposed change will apply to dividends received on or after January 1, 2024.

Expanded scope of deduction for labour costs of executives and employees dispatched to overseas subsidiaries

A deduction of labour costs for executives and employees dispatched to overseas subsidiaries is currently available only to small and midsize enterprises (SMEs) and middle standing companies, subject to certain conditions.

Specifically, an overseas subsidiary must be directly or indirectly 100% owned by a qualified company, and the labour costs paid by a qualified company are less than 50% of the total labour costs paid by the domestic company and its overseas subsidiary. Under the Bill, it is proposed to expand a deduction of labour costs to all domestic companies, regardless of the size of the companies, if the prescribed conditions are met. Also, the Bill proposes to add the additional condition that the domestic company withholds payroll income taxes on dispatched executives and employees of its overseas subsidiaries who are Korean residents under the Individual Income Tax Law and paid the withheld income taxes in Korea.

Foreign tax credit for the tax amount that exceeds a reduced treaty rate in violation of the Korea-Russia tax treaty

Foreign income taxes (excluding penalties) paid or payable in a foreign country in accordance with an applicable tax treaty are generally eligible for a foreign tax credit against a Korean taxpayer's Korean income taxes payable with certain limits. However, an excess amount of foreign income taxes over a reduced treaty rate under an applicable tax treaty would not be eligible for a foreign tax credit in Korea. Nonetheless, in order to resolve double taxation arising from the suspension of the Korea-Russia tax treaty, it is proposed that the foreign tax credit will be available for the tax amount imposed in Russia that exceeds the reduced treaty rates in violation of the Korea-Russia tax treaty, including the tax amount imposed in Russia that exceeds a reduced treaty rate due to Russia's suspension of tax treaty. The proposed rule is applicable for foreign taxes paid on or after August 8, 2023.

Value Added Tax (VAT) Law

New provision for the registration of business place by the tax authority in its power of authority for a foreign supplier subject to the simplified VAT registration

The Value Added Tax Law (VATL) requires any entrepreneur starting a business in Korea to register its business place with the tax authority within 20 days from the commencement date of the business. Currently, for non-compliance with the registration requirement within 20 days, the registration shall be made by the head of the competent tax office in its power of authority. This rule is proposed to apply to a foreign supplier (a foreign company or a non-resident) supplying any of prescribed electronic services to consumers in Korea which is subject to the requirement for simplified VAT registration but fails to register a business place within 20 days from the commencement date of the business under the VATL.

Special Tax Treatment Control Law (STTCL)

Expanded scope of qualified foreign engineers for employment income tax reduction

Currently, qualified foreign engineers who meet prescribed criteria are entitled to a 50% reduction in income tax on their employment income for 10 years from the first service year in Korea if they start to work no later than December 31, 2026. The Bill proposes to expand the scope of qualified foreign engineers to include those who are employed as professors at schools in R&D special zones and high-tech medical complexes if they satisfy all other existing criteria such as the thresholds for R&D experience, academic qualification, etc. This proposed change will apply to income earned from the fiscal year in which the amended Presidential Decree takes effect.

Clarification on qualifying personnel expenditures eligible for R&D tax credit

Under the STTCL, certain qualifying personnel expenditures would be eligible for the research and development (R&D) tax credit. The Bill clarifies the scope of qualifying personnel expenditures eligible for the R&D tax credit, providing that employer contributions to the country's four major social security insurances(*) should be included in the scope of personnel expenditures eligible for the R&D tax credit. (* Include National Pension, National Health Insurance, Employment Insurance and Industrial Accident Compensation Insurance.)

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

The STTCL applies a higher tax credit to qualifying R&D expenditures incurred to develop and invest in 258 different kinds of technologies in 13 new growth or source technology sectors including future cars, artificial intelligence, next-generation software, etc. The Bill expands the scope of new growth or source technology sectors to include 270 different kinds of technologies in 14 sectors including defence industry. Specifically, 15 kinds of new technologies to be added to the existing list include: three kinds of energy and environmental technologies such as large-scale nuclear power plant manufacturing technology; one type of robot technology such as non-coding class technology; five kinds of high tech materials and equipment such as nano-silicon cathode material manufacturing technologies; three kinds of carbon neutral technologies such as ammonia power generation technology; and three kinds of defence industrial technologies such as propulsion system technology.

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

Currently, the STTCL provides for the highest rates of R&D tax credit for qualifying R&D expenditures incurred for any national strategic industrial technologies prescribed in the Presidential Decree of the STTCL. Currently, the existing list of national strategic industrial technologies include 62 kinds of technologies in seven industrial sectors (22 in semiconductors, nine in secondary battery, seven in vaccines, five in display, six in hydrogen, five in future transport means and eight in biopharmaceuticals. Under the Bill, it is proposed to add four kinds of technologies to the list of technologies to benefit from the highest R&D tax credit. They include: one kind of display technology such as OLED pixel formation, bagging process equipment and parts technology and three kinds of hydrogen technologies such as hydrogen gas turbine (mixed and pure) design and manufacturing technology, hydrogen reduction ironmaking technology and hydrogen storage efficiency technology.

Expansion of tax credit for share acquisition of a technology innovative SME

Under the STTCL, where a domestic company acquires shares or interest (the “shares”) in a qualified technology innovative SME (the “acquired company”) by December 31, 2024, the domestic company shall be eligible for a tax credit at 10% of the share acquisition costs of up to the value of technologies prescribed in the Presidential Decree of the STTCL if all of the requirements are met. They include the ownership requirement that (i) the domestic company should acquire more than 50% of the shares in the acquired company (or 30% of the shares if the domestic company is the largest shareholder and substantially controls over the management rights of the acquired company) within the fiscal year in which the initial share acquisition date falls or by the end of the fiscal year following the fiscal year in which the initial share acquisition date falls (the “fiscal year qualifying the ownership requirement”) and (ii) it should continue to own the shares as of the end of the fiscal year qualifying the ownership requirement under the latest amendment of the STTCL (rather than the end of the fiscal year in which the initial share acquisition date falls before the latest amendment of the STTCL).

In line with the extended period for the shares acquisition by the domestic company to be eligible for a tax credit for share acquisition of a technology innovative SME under the recently amended STTCL, it is proposed that the value of technologies eligible for the concerned tax credit is determined at either of the following amounts selected by the domestic company: i) value calculated by an appraisal agency × the ownership ratio as of the end of the fiscal year qualifying the ownership requirement; or ii) acquisition price – fair market value of net assets of the acquired company × ownership ratio as of the end of the fiscal year qualifying the ownership requirement.

Increase in the value of technologies eligible for a tax credit for technology innovative M&A

Where a domestic company (surviving or acquiring company) merges with or acquires shares in a qualifying technology innovative SME (dissolving or acquired company) by December 31, 2024, the domestic company shall be eligible for a tax credit at 10% of the share acquisition costs of up to the value of technologies prescribed in the Presidential Decree of the STTCL if all of the requirements are met. The value of technologies prescribed in the Presidential Decree refers to either of the following amounts selected by the domestic company: i) the total amount of patent rights, utility model rights, and certain technical knowhow or technology, etc. held by the dissolving or acquired company; or ii) the amount calculated by subtracting **130%** of the fair market value of net assets of the dissolving or acquired company from the transfer price paid by the domestic company to the dissolving or acquired company. Under the Bill, in calculating the amount based on the fair market value of net assets of the dissolving company in ii), the subtraction percentage will be lowered from 130% to **120%**.

Eligibility criteria for additional tax credit for video contents production costs

The recently amended STTCL has expanded tax incentives for qualifying expenditures or costs incurred to produce video contents (TV series of drama, animation as well as documentary, films and over-the-top (OTT) contents). The expanded tax incentives include an increase in the basic credit rates from 3%, 7% and 10% to 5%, 10% and 15% depending on the corporate type (i.e., large company, middle standing company and SME) and the introduction of additional tax credits at 10% for large company and middle standing company and 15% for SME if the conditions prescribed in the Presidential Decree are met. Under the Bill, the proposed conditions for the additional tax credits are as follows: 1) domestic expenditures should account for at least 80% of the total production costs; and 2) at least three of the following conditions should be fulfilled: i) at least 80% of the qualifying personnel expenses for writers and staffs should be paid to those who are residents in Korea; ii) at least 80% of the qualifying performance fees for actors should be paid to those who are residents in Korea; iii) at least 80% of the qualifying post-production costs should be spent domestically in Korea; and iv) at least three out of six specified major intellectual properties* should be held (*includes broadcasting rights, transmission rights, performance rights, reproduction rights, distribution rights, and the right to create derivative works under the Copyright Act).

Special provision for deduction of bad debt allowance for loans to overseas construction subsidiaries.

The recently amended STTCL introduced a special provision for a deduction of bad debt allowance for qualifying loans extended by a qualifying domestic construction company to its qualifying overseas construction subsidiaries, subject to the specifics prescribed in the Presidential Decree. Under the recently amended STTCL, a deduction limit of the bad debt allowance is calculated at the year-end balance of qualifying loans of the qualifying domestic construction company minus the book value of net assets (excluding the concerned loans) of the overseas subsidiary, multiplied by a deduction ratio. The deduction ratio is set at 10% for FY2024 and is increased by 10% point every year until the ratio reaches 100% in FY2033.

Further, the Bill proposes the requirement of a foreign construction subsidiary and other specifics for the application of special provision for a deduction of bad debt allowance as follows:

- The overseas construction subsidiary must be a local subsidiary in accordance with the Overseas Construction Promotion Act, and 90% or more of the shares or interest in the overseas subsidiary should be held by the domestic construction parent company.

- The scope of the domestic parent company's qualifying loans for bad debt allowance includes loans and related interest, and receivables arising from the domestic parent company's payments of salaries and wages to the executives or employees dispatched to its overseas construction subsidiaries.

- The concerned loans would be considered non-recoverable in either of the following cases where: 1) the overseas subsidiary has consistently suffered from negative equity* for the preceding 10 years (*It refers to the case where the cumulative losses exceed the fair market value of net assets or where the fair market value of net assets is below zero); or 2) as an equivalent case to 1), confirmation on the unrecoverable loans has been obtained from an overseas debt collection agency.

For the application for the special provision of bad debt allowance, the domestic company must submit a written application for the provision to the competent tax office, along with its corporate income tax returns filed.

Law for Coordination of International Tax Affairs (LCITA)

Proposed change to enhance exceptions to the application of CFC rules for foreign holding company

Under the Korean controlled foreign corporation (CFC) rule, when a Korean company, together with its related parties, directly or indirectly owns at least 10% in a foreign corporation and the foreign company's average effective income tax rate for the three most recent consecutive years is 16.8% or less (the level of 70% of the top marginal corporate income tax rate of 24% at present from the fiscal year beginning on or after 1 January 2023), the undistributed earnings of the CFC shall be deemed to be paid as a dividend to the Korean national thereby subject to corporate income tax in Korea. There are certain exceptions to the application of the CFC rule, particularly where the CFC falls under a qualified foreign holding company and the passive income such as interest and dividend income earned by the CFC from its subsidiaries account for 90% or more of its total income as at a fiscal year-end. In calculating the ratio of passive income to total income of the foreign holding company, the Bill proposes to include interest income on savings and time deposits of interest and dividend income earned by the foreign holding company from its subsidiaries in the passive income while excluding interest income on other income sources.

Proposed details outlining the new requirement for submitting data on offshore trusts.

The recently amended LCITA introduces the new reporting requirement that residents and domestic corporations must submit the required information concerning offshore trusts. An offshore trust refers to a trust formed under the laws of a foreign jurisdiction and is in nature similar to trusts of the Korean Trust Act. The Bill proposes the specifics of the new reporting requirement as follows:

- Where an offshore trust has been created, the trustor would be obliged to submit the required information every year in case it substantively governs and controls over the trust property. The term 'substantively governing and controlling over the trust property' would pertain to situations where the trustor retains the right to terminate a trust, the right to appoint or alter beneficiaries, or the right to distribute remaining assets after termination, among other related actions.

- The fair market value would in principle constitute the value of offshore trust property subject to the reporting requirement. In this regard, in the case of cash, stocks, bonds, collective investment securities, insurance policies and virtual assets, their fair market value would be determined based on the amount or price as of the reference date for assessing the fair market value. (The reference date would be the end of the fiscal year of the offshore trust or the trust termination date in case where substantive control is exercised. In other cases, it would be the date when an offshore trust is created or the property is transferred to the offshore trust.)

- As an exception, in the case where it is difficult to determine the fair market value of offshore trust property – that said, where there is no price that is generally agreed in cases where transactions are freely executed among unspecified number of unrelated parties – the acquisition cost would serve as the value for offshore trusts.

- Noncompliance with the submission requirement would be subject to a penalty of 10% of the trust property value with a cap of KRW 100 million.

The proposed rules would apply to trusts with an obligation to submit required information for the fiscal year starting on or after January 1, 2025 (with the submission occurring after January 1, 2026).

Proposed Refinements to the Global Minimum Tax Rules

The Bill includes proposed amendments, seeking to refine the global minimum tax rules. Proposed refinements to the rules are summarized below.

Calculation of top-up-tax amount in case of the top-up-tax percentage exceeding 15%

Where the top-up-tax percentage exceeds 15%, in other words, the adjusted covered tax amount is negative and the net GloBE income is positive, the recently amended LCITA outlines the tax computation method as follows: i) calculate the top-up tax amount at the global minimum tax rate of 15% for the relevant fiscal year when the net GloBE income arises; and ii) deduct the tax amount exceeding 15% from the adjusted covered tax when computing the effective tax rate for the subsequent fiscal year, as specified in the Presidential Decree of the LCITA. With respect to this, the Bill proposes that where the top-up-tax percentage exceeds 15% for a fiscal year, the excess top-up tax amount would be carried over to the subsequent fiscal years in the following manner: 1) deduct the excess amount from the adjusted covered tax amount in the first subsequent fiscal year when the net GloBE income arises; and 2) carry over the remaining balance of the unused excess tax amount to the following subsequent fiscal year when the net GloBE income arises.

Requirements for exemption of top-up tax paid under Qualified Domestic Minimum Top-up Tax (“QDMTT”) of other jurisdictions

Under the LCITA, the top-up tax of the domestic constitution entity would be exempt if (i) the top-up tax, excluding the QDMTT top-up tax in the jurisdiction in which a foreign constituent entity in the MNE group is located, is equal to or less than zero; or (ii) the QDMTT system of the jurisdiction in which the foreign constituent entity is located aligns with the financial accounting standards and other criteria in the Presidential Decree of the LCITA for the exemption of the top-up tax for a fiscal year. Regarding this, the Bill would introduce exemption criteria for QDMTT in accordance with the OECD/G20 Administrative Guidance on the GloBE Rules as presented below.

1. (Accounting requirement) Constituent entities in a jurisdiction adopting the QDMTT must adhere to the accounting standards applied in preparing consolidated financial statements of the ultimate parent entity under the GloBE rules or certified local accounting standard of the jurisdiction;
2. (Consistency requirement) An additional top-up tax imposed under the QDMTT of the jurisdiction should be equal to or greater than the top-up tax amount computed according to the GloBE rules;
3. (Administrative requirement) In assessing the fulfillment of requirements 1 and 2, compliance with the OECD peer review standards should be ensured.

New proposed requirements for Qualified Undertaxed Profits Rule (“UTPR”)

The amended LCITA introduces the qualified UTPR as supplementary rules for income inclusion rules for income inclusion which may be applicable to top-up tax liability for constituent entities with low-taxed income of a MNE group, provided that the requirements specified in the Presidential Decree of the LCITA are met. Under the Bill, it is proposed that the qualified UTPR must meet all of the following requirements:

- It must be implemented in a manner consistent with the outcomes of the GloBE rules (OECD consensus).
- It must be ensured that the relevant UTPR jurisdiction does not provide benefits associated with the qualified UTPR rules for entities bearing top-up tax liability under the GloBE rules.

The proposed requirement will apply from the fiscal year beginning on or after January 1, 2025.

Transitional penalty relief for noncompliance with the submission of GloBE information return

Under the LCITA, where the domestic filing constituent entity, which is obliged to submit the GloBE information return, fails to submit or falsely submit the return by due date, there would be a penalty of up to KRW 100M for the non-submission or false submission of the return. However, the penalty for the non-compliance shall be exempt for a transitional period* if the requirements specified in the Presidential Decree are met. (*the transactional period applies to fiscal years beginning on or before December 31, 2026 and ending on or before June 30, 2028.)

The Bill proposes the penalty exemption for noncompliance with the submission of GloBE information return during the transitional period if any of the following requirements is satisfied:

- Full disclosure of the computation details of GloBE income or loss is provided to the tax authority.
- Reasonable instances of misunderstanding by the filing constituent entity during return preparation mistake is identified.
- A reasonable likelihood of errors occurring the return preparation is acknowledged.
- The interpretation of relevant tax laws is considered as reasonable.
- No reduction in the tax liability is anticipated for the current or future years.

Individual Income Tax Law

Proposed refinements to compulsory reporting of transaction details related to employee stock-based compensation

The recently amended Individual Income Tax Law introduces a new provision mandating Korean companies or the permanent establishments (PE) of foreign companies to disclose transaction particulars related to stock options and stock-based compensation for its executives and employees, which have been granted by a foreign company that is an overseas controlling shareholder. The proposed amendments in the Bill aim to enhance and clarify the reporting requirements for these transactions, as outlined below.

- **Scope of foreign company which is an overseas controlling shareholder**. In case of executives and employees of a Korean company, overseas controlling shareholder company refers to the foreign company directly or indirectly owning 50% or more interest in the Korean company as per Article 45(1)(1) of the Presidential Decree of the LCITA. In case of executives and employees of the Korean PE of a foreign company, the head office or another PE of the foreign company, or another foreign company directly or indirectly owning 50% or more interest in the former foreign company as per Article 45(2)(1) and (2) of the Presidential Decree of the LCITA.

- **Definition of overseas stock-based compensation**. It is defined as: 1) bonus received in the form of shares or cash equivalent to the value of shares; and ii) remuneration paid by an overseas controlling shareholder in shares or money equivalent to the share value according to the pre-determined operating guidelines of stock-based compensation.

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