Tax News Flash

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MOEF Announces Korea's tax reform proposals for 2024

The Ministry of Economy and Finance (MOEF) published Korea's tax reform proposals for 2024 on July 25, 2024. The reform proposals aim to facilitate corporate investment, employment, and regional development, as well as to enhance corporate competitiveness and transparency of revenue sources. Some of the key features of the proposals include extending and adjusting R&D and investment tax credits, streamlining employment-related tax credit schemes, introducing new tax incentives aimed at enhancing shareholder returns, modifying the residency test for tax purposes, and preparing a basis for implementing crypto asset reporting. Additionally, the proposals suggest withdrawing the planned financial investment income taxation regime and postponing the taxation of virtual assets by two more years. The finalization of the proposed changes will be subject to further deliberation and approval by the National Assembly. If approved by the National Assembly, most of the proposed changes will be implemented in January 2025 unless otherwise specified.

Proposals aimed at Facilitating Corporate Investment, Employment and Balancing Regional Development

Extension of Applicable Period of Tax Credits for National Strategic Technologies

- Under the proposal, the sunset date of the current R&D tax credits for seven categories of national strategic technologies as well as 14 categories of new growth and source technologies will be extended by three-years from December 31, 2024 to December 31, 2027. However, there is no change in the R&D tax credit rates for these technologies ranging from 20% to 50%.
- In addition, the sunset date of the current integrated investment tax credits for investment to commercialize those national strategic technologies will also be extended from December 31, 2024 to December 31, 2027. The investment tax credit rates will remain unchanged, ranging from 15% to 29%.

Adjustment of Additional Tax Credit for Incremental Investment Expenditures. Currently, investment tax credits are available for business-purpose tangible assets. The basic credit rates for investment tax credits vary depending on the corporate scale and the type of specific facilities, ranging from 1% for general facility investments by large corporations to 25% for investments by small and midsize enterprises (SMEs) in facilities aimed at commercializing designated national strategic technologies. In addition, an additional tax credit of 3% to 4% is available for incremental investment expenditures (i.e., investment amounts exceeding the previous three-year average). Under the proposal, this additional tax credit will be increased to 10%, regardless of corporate scale or type of facility.

Changes in Middle-scale Corporate Criteria

- Two proposed changes are regarding the existing criteria for middle-scale companies. One proposed change would add real estate rental businesses to the list of sectors disqualified from meeting these criteria, alongside consumption-oriented services, banking, insurance, pension services, and other related financial services.
- The other proposed change pertains to the annual gross sales threshold, which currently includes an average of KRW 300 billion over the previous three years (or KRW 500 billion if receiving R&D tax credits). The new proposal suggests that the annual gross sales threshold be three times the specified amount by business type (or five times if receiving R&D tax credits). The specified amounts range from KRW 40 billion (e.g., accommodation and food services) to KRW 150 billion (e.g., garment manufacturing, primary metal manufacturing, etc.).

Extension of the Grace Period for SMEs. The grace period for companies, which came to exceed the criterion of SME in scale, would be increased from three years to five years (seven years for those listed on the Korea Exchange or the KOSDAQ). Designed to establish a ladder for SME growth, the proposed change will apply to businesses that exceed SME criteria in the fiscal year in which the amendment takes effect.

Gradual Reduction in R&D and Investment Tax Credits after the Grace Period

- As presented in bold below, the government's bill proposes a gradual reduction in R&D tax credits and investment tax credits for middle-scale companies during an additional three (or five) year period after the transition of SMEs to middle-scale companies following the grace period for SMEs.

R&D tax credits for qualifying expenditures on research staff and R&D activities after the grace period

Category	Basic credit rate				Additional credit rate
	Large	Middle-scale (current)	**Middle-scale (proposed)**	SME	
General technology	2%	8~15%	**8%~20%** 1)	25%	
New growth and core technology	20%	20%	**20%, 25%** 2)	30%	Up to 10%
National strategic technology	30%	30%	**30%, 35%** 3)	40%	Up to 10%

1) 20%for the first three years after the grace period, 15% for next two years and 8% from the sixth year onwards; Currently, 15% for the first three years after the grace period, 10% for the next years and 8% from the sixth year onwards
2) 25% for the first three years after the grace period and 20% from the fourth year onwards
3) 35% for the first three years after the grace period and 30% from the fourth year onwards

Investment tax credits for qualifying business-purpose tangible assets after the grace period

Category	Basic credit rate				Additional credit rate 4)
	Large	Middle-scale (current)	**Middle-scale (proposed)**	SME	
General technology	1%	5%	**5%~7.5%** 1)	10%	3%
New growth and core technology	3%	6%	**6%, 9%** 2)	12%	3%
National strategic technology	15%	15%	**15%,20%** 3)	25%	4%

1) 7.5% for the first three years after the grace period, 5% from the fourth year onwards
2) 9% for the first three years after the grace period and 6% from the fourth year onwards
3) 20% for the first three years after the grace period and 15% from the fourth year onwards
4) It is proposed to increase an additional credit rate from 3%/4% to 10%

Streamlining Integrated Employment-Related Tax Credit Schemes

- Two significant changes are being proposed to the existing integrated employment-related tax credits available for qualifying employees in SMEs and middle-scale companies. One proposed change is to expand the scope of qualifying employees eligible for tax credit to include fixed term employees who have employment contracts for periods of at least one month, but less than one year, and short-time workers (working for less than 15 hours per week).

- Another proposed change is to increase the amount of tax credits for continuous employment and introduce a new tax credit for flexible employment for SMEs and middle-scale companies, aimed at promoting flexible employment practices. These proposed changes are detailed in the table below.

		Proposed Tax Credits (in KRW thousands, %)			
		SME		Middle-scale	Large
		Metropolitan region	Non-metropolitan region		
Continuous employment	Youth, Disabled, Aged over 60, rehired after parental leave, etc.	22,000 (up from 14,500)	24,000 (up from 155)	12,000 (up from 8,000)	4,000 (no change)
	Others	13,000 (up from 8,500)	15,000 (up from 9,500)	7,000 (up from 4,500)	-
Flexible employment	3%~20% payroll increase	20% of the increase in payroll		10% of the increase in payroll	
	At least 20% payroll increase	40% of incremental increase exceeding the 20% increase		20% of incremental increase exceeding the 20% increase	

- The reform bill proposes to abolish the current requirement for continuous employment retention to avoid recapturing the credited amount. Instead, it is proposed to provide tax credits for an additional year if the requirements for continuous employment are met. The additional tax credits available for transitioning non-regular workers to regular employment and for returning employees after parental leave for SMEs and middle-scale companies will be incorporated into the basic tax credits for credits of up to KRW 48 million for two years for continuous employment increases. The additional tax credit for transitioning non-regular workers is scheduled to terminate at the end of December 2024, while the tax credit for returning employees from parental leave is set to terminate at the end of December 2025.

- Additionally, the proposals introduce a new requirement increasing the number of employees required to qualify for employment-related tax credits. Specifically, middle-scale companies would need to hire at least 10 new employees in the relevant fiscal year, while large companies would need to hire at least 20 new employees.

Changes to Enhance the Corporate Competitiveness and Robust Capital Market

Elimination of Premium in Valuation of Shares Owned by the Largest Shareholder. The reform bill proposes to eliminate the existing 20% premium added to the value of company shares held by the largest shareholders and their related parties under the Inheritance and Gift Tax Law (IGTL), regardless of the size of company subject to the share valuation. Currently, no premium is added to the value of certain shares as prescribed in exception cases under the IGTL (e.g., SMEs or middle-scale companies with less than KRW 500 billion in annual sales) even if the shares are held by the largest shareholders. Under the proposal, no premium will apply in computing the value of shares held by the largest shareholders without regard to such exceptions.

Proposed New Tax Incentives Aimed at Enhancing Shareholder Returns

- The government's bill proposes new tax incentives for corporations listed on the Korea Exchange and KOSDAQ that demonstrate greater shareholder returns. Real estate investment trusts, real estate investment companies, special purpose companies, and special purpose acquisition companies will be excluded from these proposed incentives.
- To qualify for the tax incentives, corporations must meet both of the following requirements: i) publicly disclose plans to enhance shareholder returns by the end of the relevant fiscal year; and ii) ensure that shareholder returns (through dividend payouts sourced from retained earnings or cancellation of treasury stock) exceed those of the previous year and increase by at least 5% relative to the average returns over the past three years.
- The proposed tax incentives include a 5% corporate income tax credit for the incremental amount exceeding the average shareholder returns by 5% compared to the previous three years. The credit amount is calculated using the following formula: 〔Amount of shareholder returns for the current year} − {Average returns for the previous three years} x 1.05〕 x (1 – an equity ratio of the controlling shareholder, etc.)
- The tax credit will be capped at 1% of the total amount of shareholder returns for the current year. These proposed tax incentives will be temporarily applicable from January 1, 2025, through December 31, 2027.

Changes to Enhance the Revenue Source Transparency

Modifications to the Residency Test

- An individual is currently considered a resident of Korea if the individual has a domicile in Korea or has an abode in Korea for at least 183 days during one taxable period. Additionally, it is proposed that an individual will be considered a resident of Korea if the individual consecutively has an abode in Korea for at least 183 days during any two taxable periods. This aims to clarify the definition of a resident of Korea.
- Currently, the period of departure for clearly temporary purposes, such as tourism or medical treatment, is included in the period of residence in testing the 183-day residence threshold. The proposal further specifies qualifying reasons for temporary purpose departures to include personal circumstances such as tourism, medical treatment, visiting relatives, business-related reasons such as business trips and professional training, and other similar reasons.
- The proposals will clarify that the taxable period should generally be based on the calendar year (January 1 to December 31). Currently, if a resident's status changes to non-resident, the taxable period starts from January 1 until the exit date. The term 'exit' refers to the transfer of the resident's domicile or abode outside Korea. Under the proposal, for non-residents, the taxable period begins the day after the exit date and continues until the end of the taxable period. For residents transitioning from non-resident status, the non-resident taxable period will last until the day before the transition, and the resident taxable period will begin on the date they become a resident.
- The proposed changes to supplement the residency test will be applicable to taxable periods starting on or after January 1, 2026.

Preparation for Implementing Automatic Exchange of Information on Crypto-Assets

- Under the Law for Coordination of International Taxation Affairs (LCITA), financial institutions are required to compile and report financial transaction information of reportable taxpayers to the Korean tax authorities. This information may be exchanged with the competent authority of the counterpart country involved in the transactions. Information on crypto-asset transactions will be added to the information subject to intergovernmental exchange. This proposal aims to align with the OECD initiative to prevent tax avoidance by enabling the automatic exchange of tax relevant information on crypto assets.

- The term "crypto asset" refers to a digital representation of value that relies on a cryptographically secured distributed ledger or similar technology to validate and secure transactions. Further details will be specified in the Presidential Decree of the LCITA.
- Financial institutions and crypto-asset service providers must report information relevant to crypto-asset transactions. Failure to comply with this reporting obligation may result in a maximum penalty of KRW 30 million.
- Due diligence procedures will apply to counterparties of reportable financial transactions as well as reportable crypto-asset transactions.
- The requirement for the exchange and submission of crypto-asset information will be applicable from January 1, 2027. Due diligence procedures will be applicable from January 1, 2026.

Other Proposed Changes

Withdrawal of financial investment income tax regime and two year deferral of virtual asset taxation. It is proposed to withdraw the financial investment income tax regime (for the comprehensive taxation of income arising from shares, bonds, funds, investments in contract securities, derivative linked securities, derivatives, etc., effective from January 1, 2025), and instead continue to maintain the existing capital gains taxation regime. Also, under the proposal, the taxation of income arising from a transfer or lending of virtual assets will be deferred for two additional years from January 1, 2025 to January 1, 2027.

Relaxation of penalties for non-compliance with foreign financial accounts reporting requirements. Under the proposal, the penalties will be relaxed as follows: i) the progressive penalty rate, currently ranging from 10% to 20%, will be unified into a single penalty rate of 10% on the non-reported or under-reported amount; ii) the penalty cap, currently set at KRW 2 billion, will be lowered to KRW 1 billion; and iii) failure to provide an explanation or providing a fraudulent explanation will incur a penalty of 10% of the failed or violated amount, compared to 20% at present.

Expansion of amended tax returns for tax refund requests on tax credits. Currently, a taxpayer who filed a tax return within the statutory due date may submit an amended tax return for a tax refund request to the relevant tax office within five years after the statutory due date of the original tax return where the tax base and tax payable were overreported, or tax losses or refundable taxes were underreported. Under the proposal, a taxpayer will also be allowed to submit an amended tax return for a tax refund request if tax credit amounts are underreported.

Special provision for the statute of limitations for tax credit carryforward. Under the current tax laws, in general, the statute of limitations extends to five years for underreported taxes and seven years for non-reported taxes, with some exceptions, and tax credits unused due to no tax liability or the minimum tax rules can be carried forward for up to 10 years. Under the proposal, where a tax credit is carried forward to and is used in a fiscal year after the statute of limitations for national taxes have lapsed (five or seven years, etc.), a special statute of limitations would apply and last for a period of one year from the fiscal year in which the tax credit is utilized. In such case, it is necessary to maintain the relevant books and evidential documents for the fiscal year in which the tax credit occurred until the time when the special statute of limitations applies.

Extended period of the prior notice of intended tax audit. Tax auditors must deliver a written notice of intended tax audit to taxpayers 15 days before the audit begins. Under the proposal, this notification period will be increased to 20 days. Additionally, in cases of re-examination as determined by decisions on tax appeals, the prior written notice period is proposed to be seven days.

Proposed Amendments pertinent to International Taxation

Application requirement for Korean-source personal service income to avail of tax treaty exemption. Under current Korean income tax laws, non-residents or foreign corporations seeking tax exemption for Korean-source income (excluding business income and personal service income) under applicable tax treaties must submit to the competent tax office an application for tax treaty exemption and evidential documents supporting its beneficial/substantive ownership of the Korean source income. Under the proposal, Korean-source personal service income would no longer be excluded from the exemption application requirements, and would be required to comply with the application requirements in order to seek tax exemption under applicable tax treaties. This proposed change will be effective for income paid on or after January 1, 2026.

Requirement for submission of payment statement for Korean-source personal service Income

Under current Korean income tax laws, where individual residents or domestic corporations pay Korean-source income to non-residents or foreign corporations, they are required to submit statements of payment to the competent tax offices. Certain types of income that are excluded from this requirement include: Korean-source income attributable to permanent establishments of non-residents or foreign corporations, income for which applications for tax treaty exemption are submitted; Korean-source business income; and Korean-source personal service income, among others. However, the exclusion from this requirement will no longer apply to payments of Korean-source personal service income. This proposed change will be effective for payments made on or after January 1, 2026.

Proposed amendments to tax refund requests based on arm's length price adjustments

In international transactions between a Korean resident (including domestic corporation and domestic place of business) and its foreign related parties, where the transaction price is lower or higher than an arm's length price, the LCITA allows the resident to submit an amended tax return for a tax refund request, along with a statement on the adjustment of transaction prices, to the competent tax office by seeking an adjustment of the transaction price to the arm's length price. The amended tax return for a tax refund request should be filed within the statutory deadline specified under the Basic National Tax Law, which is generally five years from the statutory due date for the tax return. It is proposed that, in addition to the statement on the adjustment of transaction prices, a document evidencing the arm's length price should also be submitted for this refund request, demonstrating the appropriateness of the method used to calculate the arm's length price as prescribed in the MOEF ordinance.

Currently, the tax authorities are required to determine whether to accept or reject an amended tax return for a refund request within two months from the date on which the request is submitted. However, it is proposed to extend this deadline from two months to six months for amended tax returns for tax refund requests based on arm's length price adjustments. Furthermore, where deemed necessary, the tax authorities may request a taxpayer to provide supplementary documents within 30 days. The period for providing supplementary documents will not be counted towards the six-month deadline.

Proposed Amendments to Global Minimum Tax Rules

Changes are proposed to clarify certain definitions that are used in the domestic global minimum tax (GloBE) rules under the LCITA. In addition, the reform proposals supplement the existing rules, which include, among other amendments, the following.

- **Exception to De Minimis exclusion**: Under the current LCITA, notwithstanding other provisions, and at the election of a filing constituent entity for each fiscal year, the filing constituent entity may treat the top-up tax for each constituent entity located in a jurisdiction to be zero (0) for a fiscal year, as prescribed by the Presidential Decree, if the jurisdiction meets all of the following conditions: i) the average GloBE revenue of the jurisdiction for the current and the two preceding fiscal years is less than EUR 10 million; and ii) the average GloBE income or loss of the jurisdiction for the current and the two preceding fiscal years is a loss or is less than EUR 1 million. The proposal provides an exception to the de minimis exclusion that where there is any change* in the jurisdiction's status of meeting the conditions for the de minimis exclusion for a fiscal year due to reasons such as post-filing adjustments after the GloBE return is filed, the de minimis exclusion would not be applicable for the fiscal year. *It includes both the cases (i) where a jurisdiction that met the conditions for the de minimis exclusion at the time of filing no longer meets the conditions and (ii) where a jurisdiction that did not meet the conditions at the time of filing subsequently meets the conditions.

- **New provisions for the safe harbor rules.** The proposal provides a new provision for the general safe harbor rules that where a tested jurisdiction meets the conditions for exemption on the basis of the consolidated financial statements, the top-up tax of the qualified jurisdiction may be deemed to be zero (0). The conditions for exemption include (i) de minimis test, (ii) effective tax rate of 15% or higher or (iii) routine profits test, and further details are prescribed in the Presidential Decree of the LCITA. Another new provision addresses the transitional safe harbor rules for the exemption from the application of undertaxed payments rules ('UTPR') whereby the top-up tax of the UTPR jurisdiction is deemed to be zero (0) during a transition period beginning on or before December 31, 2025, and ending on or before December 30, 2026. To qualify for this transitional exemption, the nominal tax rate in the jurisdiction where the ultimate parent entity resides must be at least 20%.

- **Special provision on GloBE information return filing deadline.** Under the LCITA, a domestic constituent entity shall file a GloBE information return with the competent tax office, no later than 15 months after the end of the relevant fiscal year (extended to 18 months in the first year of application). Under the proposal, where the return filing deadline falls before June 30, 2026, the filing deadline will be extended to June 30, 2026.

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

삼일회계법인 서울특별시 용산구 한강대로 100 (04386)
www.samil.com | Email | 02-3781-3131