Samil Commentary
Korean Tax Update

Amendments to Increase Tax Benefits for Employment Growth

The government's bill to amend the Special Tax Treatment Control Law was approved by the National Assembly on March 30, 2017. Effective April 18, 2017, the amended law includes changes to increase the existing tax benefits to facilitate job creation amidst sluggish employment growth. Provided below is a brief summary of major changes contained in the amended law.

Temporary increase in additional tax credit for job creating investment

Companies are allowed to claim an additional tax credit at a percentage of certain investment in business assets within the ceiling as determined by the number of new employment. The additional tax credit rate shall increase by 2% points (from 4-6% to 6-8%) for small and midsize enterprises (SMEs), by 1% point (from 4-6% to 5-7%) for medium-scale companies. This increase will be temporarily made available until the end of 2017. The existing ceiling for additional tax credits shall be determined at KRW 15 million or KRW 25 million multiplied by the number of new employment (or KRW 10 million or KRW 20 million in case of medium scale corporations as well as large corporations.)

Increase in tax credit to subsidize youth job creation

Companies are allowed to claim a tax credit for the net job creation of youth if the number of regular youth employees in a current year exceeds the number of youth employees in the preceding year. The threshold will increase from KRW 5 million to KRW 10 million for SMEs, from KRW 5 million to KRW 7 million for medium-scale companies and from KRW 2 million to KRW 3 million for large corporations.

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Increase in tax credit for transition to permanent employee

If companies convert their temporary workers into permanent workers by the end of 2017 as prescribed in the tax law, a certain amount for the increased number of permanent employees would be allowed as a tax credit. The tax credit amount will increase from KRW 2 million to KRW 7 million per permanent employee in case of SMEs. Under the amendment, the tax credit would be newly available for medium-scale companies with the credit of KRW 5 million per permanent employee.

Korea – Kenya Income Tax Treaty Enforced

Effective April 3, 2017, the Korea-Kenya income tax treaty came into force seven months after the National Assembly ratified the income tax treaty on September 7, 2016 and three years after both countries signed the income tax treaty in Nairobi, Kenya in July 2014. The summary of the key provisions include:

- Korean taxes covered by the treaty include individual income tax, corporate income tax, special tax for rural development and local income tax in Korea. In case of Kenya, the covered tax includes income tax.
- A construction project constitutes a permanent establishment if it lasts more than 12 months.
- The withholding tax rate on dividends is limited to 8% if the beneficial owner is a company (excluding partnership) that holds directly at least 25% of the shares in the company paying the dividends or 10% in other cases.
- The withholding tax rate on interest is limited to 12%.
- The withholding tax rate on royalties is limited to 10%.

Please note that for the above provisions, they have effect in Korea for the amount payable on or after January 1, 2018 in case of withholding tax at source. Also, please note that in respect of other taxes, the treaty takes effect for the taxable years beginning on or after January 1, 2018.

Korea-Mauritius Tax Information Exchange Agreement Being Effective

The tax information exchange agreement (TIEA) signed between Korea and Mauritius took effect on April 13, 2017 after it was officially signed by both governments on August 18, 2016 and ratified by the National Assembly on March 2, 2017.

The TIEA is intended for both countries upon request to mutually share and exchange information foreseeably relevant to the administration and enforcement of the domestic laws of both countries concerning taxes covered by the agreement. Such information shall include information regarding the determination, assessment and collection of taxes covered by the agreement as well as the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters. The covered taxes

include taxes of every kind and description imposed by the Mauritius Revenue Authority and by the National Tax Service and the Customs Service of Korea. In addition, the agreement allows representatives of the concerned authority of a contracting country to enter the territory of the other contracting country and interview individuals and examine records with the written consent of the persons concerned.

This agreement is the 10th TIEA signed by Korea with the government of a foreign country. In addition to Mauritius, Korea enforced TIEAs with nine foreign countries since putting into practice its first TIEA singed with Cook Islands on March 5, 2012.

Protests Filed with Tax Tribunal Continue to Rise in 2017

The latest statistics published by the Tax Tribunal indicate that the number of protests filed with the Tribunal showed an upturn in 2017 after continuing to decrease since the peak at the end of 2014. According to the Tribunal, a total of 1,778 protests were filed with the Tribunal for the first quarter of 2017, compared with 1,623 for the first quarter of 2016. During this period, 33% of the protests filed were settled. The settlement process took an average of 163 days during the first quarter of 2017, 32 days shorter than the average of the same period of 2016.

On the contrary, the number of cases accepted averaged 24% during this period, down 8% from the same period of 2016. The acceptance rate has showed ups and downs during past years. The rate peaked at 27.8% in 2012 and declined to 22.2% in 2014. In 2016, it rose again to 25.3% and the upturn continued until the recent downturn. Analysts say that the latest trends for the settlement of protests indicate a positive sign to improve taxpayers' convenience. On the contrary, they view the latest downturn in the acceptance as an unfavorable sign for taxpayers by the fact that a declining number of taxpayers may enjoy benefits from the taxpayer relief system in contrast to an increasing number of protesting taxpayers.

Rulings Update

Whether to apply Korean GAAP in calculating distributable retained earnings under CFC rule

Korea's controlled foreign corporation (CFC) rule under the Law for Coordination of International Tax Affairs provides that the distributable retained earnings derived by a foreign corporation resident in a lower tax jurisdiction are deemed to be distributed to a Korean resident shareholder that holds, directly or indirectly, at least 10% shares in the foreign corporation. Under the CFC rule, the distributable retained earnings should be computed, in principle, based on the amount of retained earnings before appropriations as computed using generally accepted accounting principles (GAAP)

in a foreign corporation's country of residence after specific adjustments as required are made. The Korean GAAP can be used only when there is a significant difference between the Korean GAAP and the concerned foreign country's GAAP, and the burden to prove that there is a significant difference should lie with the person who argues such a difference. (*Daebeop 2015du55295, 2017. 3. 16*)

Whether onsite verification under tax audit guidelines would be treated as a tax audit subject to the rule for restriction on re-examination.

As part of the measures to improve the protection of taxpayer rights, the Basic National Tax Law (BNTL) restricts a re-investigation of the same tax item and the same tax year unless there is obvious evidence supporting tax fraud or attempted evasion or other justifiable reasons as specified by the law.

According to the tax audit guidelines by the National Tax Service, in conducting a tax audit a tax examiner may visit to a taxpayer's premises to verify factual circumstances required for an intended audit ('onsite verification') before initiating an official examination as normally notified in advance to the taxpayer. In general, the initial visit to a taxpayer's premises is not considered as the start of an official NTS examination while an official tax investigation is considered to initiate following the onsite verification.

In a case where a taxpayer and the tax authorities dispute over whether the onsite verification constitutes the start of tax examination, the Supreme Court decided in favour of the taxpayer that an onsite verification falls in the tax examination procedures if it were conducted in a way that an examiner directly contacted a taxpayer or its employees in the taxpayer's premises to detect the possibility of omitted sales and exercised the rights to question in a comprehensive manner and obtained tax documents, regardless of whether it conformed to the onsite verification procedures as provided in the NTS internal guidelines. Accordingly, the rule for restrictions on re-examination shall apply to this case, according to the Supreme Court. (*Daebeop 2014du8360, 2017. 3. 16.*).

Whether gains arising from public offering of new shares is subject to gift tax when a related party of the largest shareholder in a company has acquired new shares via third party allocation

According to Articles 41-3 and 41-5 of the former Inheritance and Gift Tax Law (effective prior to the amendment on December 31, 2011), where a related party of the largest shareholder in a company acquired new shares with consideration from the largest shareholder, etc., or where the related party acquired, with the donated property, shares of the relevant company from a person other than the largest shareholder, etc., or acquired shares of another corporation, and if the relevant corporation or another corporation has been merged with a listed company which is the related party of the relevant corporation or another corporation, within five years

from the date on which the person received the donation or acquired the underlying shares, gains arising from the merger shall be deemed a gift to the related parson. Accordingly, it suggests that gift tax would be imposed on the difference between the market value of the new shares and the paid-in amount for new shares in excess of a given threshold.

Regarding a dispute over the scope to which this rule may apply, the Supreme Court decided that this rule shall not apply to the case where gains arise from the public offering of new shares which have been issued and acquired by a related person of the largest shareholder in the company through a third party allocation method. The recent decision of the Court provides that, given that the provisions of the tax law are designed to promote the tax equality by doing so that the transfer of wealth free of tax may be subject to the liability of gift tax as if gain may be realized at the point of acquisition or donation. In light of the content, purpose, wording and logic of the underlying provisions of the tax law, the gift tax shall not be imposed in case where a related person of the largest shareholder in a company acquired new shares issued by the company through the third party allocation and there is a gain arising from the public offering of these new shares. (*Daebeop 2016du55926, 2017. 3. 30.).*

Whether to treat the excess of considerations paid over the fair market value of net assets as deductible expense if the considerations are calculated as prescribed in the Financial Investment Services and Capital Market Act

According to Article 44-2, Paragraph 3 of the Corporate Income Tax Law (CITL), when a surviving company acquires assets from the acquired company in a nonqualified merger, the excess of the consideration paid by the surviving company over the fair market value of the net assets will be included in the surviving company's deductible expenses in equal instalments over five years from the registration date of the merger, provided that it falls in those cases which are prescribed in the Article 80-3 of the Presidential Decree of the CITL.

As to the application of the rule mentioned above, a taxpayer filed an inquiry with the Ministry of Strategy and Finance. The inquiry involved a listed surviving company which would pay consideration to the shareholders of a dissolving company after calculating the consideration appropriately in accordance with the Article 176-5 of the Presidential Decree of the Financial Investment Services and Capital Markets Act. In this case, if the dissolving company without having net operating loss includes in its taxable income the excess of consideration paid by the surviving company over the fair market value of net assets as at the registration date of the merger, the Ministry advised that it constitutes one of the cases as prescribed in the Article 80-3 of the Presidential Decree, suggesting that the excess of consideration paid by the surviving company over the fair market value of the assets would be allowed as a tax deduction. (*Corporation Tax Division of the MOSF, Document no. 36, 2017. 1.* 8.).

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