Korean Tax Update

Samil Commentary

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Korean Tax Measures in response to COVID 19 Crisis

In a volatile economic environment with unprecedented challenges of the COVID 19 crisis, the government announced a series of measures to boost individual consumptions and the private sector's economic activities.

In response to the COVID 19 crisis, the government amended and enforced the Special Tax Treatment Control Law (STTCL) on March 23, 2020 to provide tax reliefs for businesses or economic activities in specific regions hit by the COVID 19 spread. Also, the amended Presidential Decree of the STTCL came into force on April 9 following the cabinet approval on April 7, 2020. In addition, proposed amendments to the enforcement rules of the STTCL will be enforced as soon as they are finalized following a public notice for April 8-14.

Significant tax measures in response to the COVID 19 crisis are summarized below.

New tax credit for store rent reduction

If a real estate rental company reduces rents on a store or commercial building for micro businesses renting the building from January 1 to June 30, 2020, it will be allowed to credit an amount equal to 50% of the rent reduction against its individual or corporate income tax. However, the tax credit will not apply if rents or rental deposits increase between February 1 and December 31, 2020 as compared with those under lease or rental agreements signed prior to the date of rent reduction.

Corporate income tax reduction for SMEs in a designated disaster area

For small-and medium-sized enterprises (SMEs) having business places in a designated disaster area (e.g., *Daegu, Cheongdo in Gyeongbuk*) as of the designation date, individual or corporate income tax on the income earned by the SMEs from the business places will be reduced by up to 60% (i.e., 60% for small-sized company and 30% for medium-sized company) for the year when June 30, 2020 belongs to. The income tax reduction will be capped at KRW200 million unless the number of full-time employees decreases from the preceding year. If the number of full-time employees decreases as compared with the number in the preceding year, the income tax reduction will be decreased by the amount which is calculated with multiplying KRW5 million by the reduced number of the employees.

VAT reduction for small sole proprietors

For small sole proprietors (with the annual revenue of KRW 80 million or less), the government will reduce their VAT liabilities by applying a simplified VAT payment scheme (where VAT payable is computed at [revenue X value added ratio for each business type X 10%]) until December 31, 2020. To apply the reduction, the final VAT returns must be filed in respect of the provision of goods or services until December 31, 2020.

Temporary exemption from VAT payment for simplified VAT taxpayers

The simplified VAT taxpayers having the annual supply price (i.e., revenue) of KRW 30 million or more but less than KRW 48 million would be exempt from VAT payment for the supply of goods or services until December 31, 2020. Note that before the law revision, the simplified VAT taxpayers refer to the business with the annual revenue of less than KRW 30 million.

Reduction in individual consumption tax on motor vehicles

Individual consumption tax on motor vehicles will be reduced by 70% for shipment from a manufacturing site or imports from March 1 to June 30, 2020. The tax reduction will be capped at KRW 1 million.

Increased income tax deductions on credit card spending

The government has doubled income tax deductions on individual spending (which exceeds 25% of total employment income during a year) between March and June 2020 by raising the deduction rates to: i) 30% (from 15%) for spending by credit cards; ii) 60% (from 30%) for spending in cash or by debit cards; and iii) 80% (from 40%) for spending on traditional markets and public transportation. (According to the MOEF press release, in its fourth series of economic meetings to cope with the COVID 19 crisis held on April 8, the government announced it would further raise the deduction rates on credit or debit card spending to 80% in respect of purchases for the most affected businesses between April and June 2020. They include restaurants and hotels, tourism, performance show-related businesses, airlines and other passenger transportation, etc.)

Increased tax limit on deductible entertainment expenses

Tax deductible entertainment expenses are limited to the amount equal to a certain percentage of sales revenue, plus KRW36 million per year for SMEs (KRW 12 million for non-SMEs). For entertainment expenses spent between January and December 2020, higher percentage rates will apply: i) 0.35% (from 0.3%) for sales revenue of up to KRW10 billion; ii) 0.25% (from 0.2%) for sales revenue of more than KRW10 billion but not

exceeding KRW50 billion; and iii) 0.06% (from 0.03%) for sales revenue of more than KRW50 billion.

Amended Act for Reshoring Companies Takes Effect in March 2020

The Act on Support for Reshoring Companies (so-called 'U-turn Act') took effect on March 11, 2020 after it was amended in the end of December 2019, according to the Ministry of Trade, Industry and Energy (MOTIE). Provided below is a brief summary of selected significant amendments to the U-turn Act.

Addition of Eligible Industry Sectors for Reshoring Incentives
Under the Act, the term 'reshoring' means that Korean companies bring into Korea their production and manufacturing facilities from overseas. Existing incentives for reshoring companies will be extended to knowledge service and information and telecommunication (IT) sectors. Currently, they are limited to the manufacturing industry. In addition, for knowledge service and IT sectors, the expansion of the area of business places or the installation of additional facilities without increasing the area of business places will be regarded as the expansion of production facilities, which is a critical factor in determining the eligibility for the reshoring incentives. In case of manufacturing industry, the expansion of production facilities refers to the establishment of a new factory or the expansion of an existing factory.

Currently, the STTCL provides for tax benefits for reshoring company, which include a 100% exemption from individual or corporate income tax for the first five years and a 50% reduction for the next two years relating to income arising from the business place which has been returned to Korea. To apply the tax benefits, certain requirements must be met as prescribed in the law, including at least two year offshore operation before reshoring.

Special rule on the use of state-owned and public property
The amended Act provides for a long-term (up to 50 years) lease of state-owned and public property, rent reduction and private contracts with qualifying companies for the use of state and public property. To apply the special treatment, facilities must be relocated into a region other than designated metropolitan areas.

One-stop service for returning companies
The one-stop service center will be located in the Korea Trade-Investment Promotion Agency (KOTRA) to handle complaints in respect of reshoring and improve the convenience of returning companies.

With the growing importance of securing the stable supply chain of flagship industries amidst the COVID 19 crisis, the MOTIE announced plans to promote and support the reshoring companies to strengthen their domestic supply chains. The MOTIE has started to take steps to implement the plans. In the past, the corporate income tax exemption or reduction for reshoring companies was only made available in case the companies establish a new business place (e.g., new factory) in Korea. The tax law has been recently amended to permit the tax incentives for reshoring companies in case of the expansion of an existing business place. In addition, the government will exceptionally permit work visas (E-9) for

foreign employees who used to work at overseas business places of domestic companies so that the companies can employ competent foreign workers in Korea.

Rulings Update

Recognizing revenue and expense for tax purpose in case a company changes its accounting method for the provision of services due to the adoption of K-IFRS 1115

Under the Corporate Income Tax Law, generally, the revenue and expenses from the provision of construction, manufacturing or other services (herein, 'construction, etc.) should be recognized as income and expense based on a percentage of completion during the period from the date of commencing construction, etc. to the date of completing it. However, exceptionally, in case a company in a SME status provides construction, etc. during a contract period of less than one year or a company records revenue and expense for the provision of construction, etc. in the year of the completion according to Korean generally accepted accounting principles, it would be allowed to recognise the revenue and expense in the year of completing construction, etc.

This ruling deals with the issue as to the recognition of revenue and expense for the provision of construction, etc. from a corporate income tax perspective in case where the tax ruling applicant (i.e., listed Korean company which is subject to the mandatory adoption of Korean IFRS or K-IFRS) changes its accounting method for recognising revenue and expense from a percentage of completion method to a completion method under the newly revised K-FIRS 1115 (*Revenue from Contracts with Customers*).

The Ministry of Economy & Finance (MOEF) responded in the ruling that, whereas revenue and expense may be recognised by the ruling applicant in the year when the provision of construction, etc. is completed due to the adoption of the K-IFRS, the revenue and expense should be recognized according to a percentage of completion method for the years prior to the year when the newly revised K-IFRS is adopted. That being said, only the remaining amount of revenue and expense which has not been recognized using a percentage of completion method could be recognised in the year of completion under the K-IFRS. As such, the MOEF interpreted that if the revenue and expense which have been recognized under a percentage of completion method in the past are reversed as a decrease in retained earnings for accounting purpose in the year when the K-IFRS is applied, there should be tax reconciliations to cancel the accounting treatment. (*MOEF, Corporation Tax Department-102, 2020. 1. 23*.)

This MOEF response may be referred in case where a company changes its accounting method of recognizing revenue and expense from a percentage of completion method to a completion method due to the application of the new K-IFRS 1115.

Starting date of computing interest on tax refund in case additional tax payment was made after the tax payment based on initial tax return filing or assessment

According to Article 52 of the former Basic National Tax Law and relevant Presidential Decree, in case the refund of national taxes arises due to the cancellation or re-assessment of tax return filing or tax assessment on which the national tax payment was based, the interest on the tax refund shall be computed from the day following the tax payment date. In case of the tax payment on two or more instalment basis, the computation of the interest shall start on the day following the final instalment payment date. However, if the tax refund amount exceeds the final instalment amount, the computation of the interest shall start on the day following the final instalment payment date and then, retroactively apply to the previous instalment date until the tax refund amount reaches the tax payment amount.

In this case, a taxpayer paid the comprehensive real estate tax for 2009 and 2010 based on the initial tax return filing or tax assessment. After that, since the tax authorities made additional tax assessment by confirming that the taxpayer had additional real property subject to such tax, the taxpayer paid additional comprehensive real estate tax on an instalment basis. Later, it was found that the taxpayer paid more than its actual tax liability due to the under-claimed property tax that is deducted from the computation of the comprehensive real estate tax, and therefore, the tax authorities should make the refund of overpaid tax. For such tax refund, there was a dispute over whether the tax authorities' additional tax assessment could be considered as 'tax payment on an instalment basis' and so, the interest on the tax refund would be computed from the day following the final instalment payment date.

For the dispute, the Supreme Court concluded that: i) the payment of additional tax based on the tax authorities' additional tax assessment would not constitute the tax payment on an instalment basis for the purpose of determining the starting date for the computation of refund interest and ii) if the tax amount to be refunded due to the cancelation or re-assessment of a portion of the total tax payment made after the tax authorities' additional tax assessment can be attributed to a part of the respective tax payment based on initial tax return filing or tax assessment, the tax refund should be considered to arise retroactively on the respective tax payment date. As such, the Court decided that since the tax refund in this case would arise in respect of the under-claimed property tax that should be deducted from each tax payment based on initial tax return filing or tax assessment and the tax authorities' additional tax assessment, the computation of the interest on the refund shall start on the day following each tax payment date. (*Daebeop2018da264161, 2020. 3. 12.*)

The Supreme Court decision in this case may be meaningful in that it first ruled on the starting date of computing tax refund interest in case the cancellation or re-assessment of tax liability based on initial tax return filing or tax assessment and the subsequent additional tax assessment by the tax authorities.

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