



Korean Tax Update

# Samil Commentary

December 15, 2021

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## The National Assembly Approves the Government's Tax Reform Bill

The National Assembly approved on December 2, 2021 the government's bill to amend 17 different tax laws. Most of the approved amendments will become effective from January 1, 2022 unless otherwise specified. Provided below is a brief summary of major changes to the original proposals the government submitted to the National Assembly on September 2, 2021.

### *Basic National Tax Law*

**Reward for Exposing Hidden Assets.** A maximum monetary reward for those who submit information that help the government detect tax fraud or hidden assets of taxpayers will increase from KRW2 billion to KRW3 billion.

### *Individual Income Tax Law*

**Taxation on Income from Virtual Assets.** The approved bill postpones the enforcement of new rules for taxation on income arising from the transfer or lease of virtual assets such as cryptocurrency, etc. for one year until January 1, 2023. The postponement is made to align with the timing of taxation for income from investment in financial instruments. However, other details contained in the government's original proposals remain unchanged.

*(For more information, please see Samil PwC Tax Newsflash, July 28, 2020 issue)*

**Tax Credit for Income Tax Payment through Taxpayers' Association.** The approved bill includes a new sunset provision that would terminate an existing tax credit for income tax payments through taxpayers' associations at the end of December 2024. Currently, a 5%



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income tax credit is available for Class B employment income earners who voluntarily report their monthly earnings and pay monthly income taxes through a licensed taxpayers' association.

**Exemption from Capital Gains Tax for One Household Owning One House.** For one household or family owning one house or the right to acquire a house as an association member, the gain on the sale of a house was exempt from income tax to the extent of KRW900 million based on the actual housing transaction price. The threshold for exemption from capital gains tax has increased to KRW1.2 billion, applicable to sales made on or after the proclamation date of the amended Law or December 8, 2021.

### *Inheritance and Gift Tax Law*

**Basic Deduction for Family Business Succession.** Currently, in the event of a family business succession, medium-scale companies with annual revenues of less than KRW300 billion shall be eligible for the basic deduction under the tax law. The annual revenue threshold for the basic deduction will increase to KRW400 billion in order to facilitate family business successions. For this purpose, family business succession refers to the business which a predecessor has continuously operated for at least 10 years.

**Instalment Payment of Inheritance Tax.** Where the amount of inheritance tax exceeds KRW20 million, a taxpayer is allowed to pay inheritance tax in annual instalments on an application basis. In most cases other than specified in the tax law, the term of instalment payments will be extended by five years from 5 years to 10 years. However, there will be no change in the period of instalment payments regarding the payment of inheritance tax due to family business succession (e.g. up to 20 years in case of inherited property from a family business succession which should account for 50% or more of the inherited property.)

**Inheritance Tax Payment in Kind.** The scheme of tax payment in kind allows an individual taxpayer to pay inheritance tax with real estate or listed or unlisted stocks and other securities if the taxpayer does not have enough cash to pay tax and meets certain requirements under the tax law. The approved bill also allows the tax payment in kind using works of art and cultural assets (subject to certain requirements and limits being met) only when it is requested by the Minister of Culture, Sports and Tourism considering their historical, academic, or artistic value. This change will apply to the inheritance made on or after January 1, 2023.

### *Valued Added Tax Law*

**Issuance of Revised Import VAT Invoice.** Currently, a revised import VAT invoice can be issued to an importer where an importer files a revised declaration knowing in advance that the tax base or the tax will 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 is not attributable to itself. In relation to the foregoing condition, the government initially proposed a negative list approach whereby revised import VAT invoices may be issued in most circumstances except specified cases. However, the proposed negative list approach has been deleted under the approved bill.

### *Special Tax Treatment Control Law*

**Tax-exempt Gains from Exercising Stock Options.** Currently, gains from exercising stock options granted by venture businesses are exempt from individual income tax to the extent of KRW30 million per year. The approved bill will raise the threshold for tax-exempt gains to KRW50 million, applicable to options exercised on or after January 1, 2022.

**Stock Options Granted at Price Lower than the Market Price.** For gains on the exercise of certain qualified stock options granted by venture firms (subject to specified conditions being met), a special tax treatment allows employees to choose not to pay income tax at the time of exercise, but pay capital gains tax when they sell the shares. Under the approved bill, the special tax treatment will apply even in the case of stock options granted at a price lower than the market price at the time of grant, provided that all other conditions are met. In this case, the difference from the market price shall be taxed as earned payroll income of employees who would exercise the options, but employees will be allowed to choose the special tax treatment for the amount exceeding the market price.

**Excess Earnings Reserve to Promote Corporate Investment & Mutual Growth.** To facilitate the use of corporate retained earnings to fund facility investment and payroll increases, a specified scope of companies including those with more than KRW50 billion in net worth are subject to additional tax at 20% of the excess corporate earnings reserve as calculated in a prescribed manner. In this regard, an amount of unappropriated earnings reserve shall be set aside for the following year. Under the approved bill, it is extended to the two following years in order to address the business environment impacted by the COVID-19 crisis. This change shall apply to the earnings reserve made from the fiscal year to which December 31, 2021 belongs.

**Establishment of Holding Company through In-Kind Contribution.** Where Korean shareholders in a domestic company establish a holding company or convert the company to a holding company no later than December 31, 2021 through an in-kind contribution, provided that prescribed conditions are met, income tax on gains arising from the in-kind contribution shall be deferred until the shareholders dispose of the shares of the holding company. Also, it is allowed to pay capital gains tax or corporate income tax on such gain in instalments over three years (from January 1, 2022 through December 31, 2024) after a four-year grace period. Under the approved bill, such special tax treatment will be available for two additional years until the end of December 2023, and, consequently, the instalment payment of tax shall be made over three years from January 1, 2024 through December 31, 2026.

**Overseas Production Costs of Video and Digital Contents.** Currently, a tax credit applies to production costs incurred by manufacturers or producers of video and digital contents in the domestic market until the end of December 2022. It will be extended to such costs incurred in overseas markets for a period from January 1 to December 31, 2022. The tax credit rates will remain unchanged, i.e. 3% for large corporations, 7% for medium-scale companies and 10% for small and midsize enterprise (SME).

## MOEF Expects the National Tax Revenue to Be KRW19 trillion Greater than the Revised National Budget in 2021

Last July the Ministry of Economy and Finance (MOEF) announced a revised estimate of KRW314 trillion in national tax revenue for 2021. This is a KRW31 trillion increase from the tax revenue projected in the initial budget (KRW283 trillion). On November 16, 2021, the Ministry said the actual collection of tax revenue would be approximately KRW19 billion more than the revised national budget of KRW314 billion in 2021 due to more vibrant than expected economic recovery and asset market factors. The excess tax revenue will be used to compensate for the losses suffered by small businesses and traditional markets amid the spread of the COVID-19 pandemic and to provide tailored support for other businesses not qualifying for the direct loss compensation plan. The rest will be carried over to the following year as a budget surplus pursuant to the National Finance Act.

## Rulings Update

### Whether the acquisition tax reduction would apply on real estate acquired by a start-up SME to operate the same line of business within four years from the date of incorporation

Article 58-3(1) of the Special Local Tax Treatment & Control Law (“SLTTL”) provides a 75% reduction in acquisition tax on real estate acquired by a qualifying start-up SME to carry on its business within four years from the date of incorporation (the ‘tax reduction provision at issue’). In addition, Article 58-3(6) of the SLTTL further provides an exclusion rule that denies the application of acquisition tax reduction to certain cases prescribed in the SLTTL, including: the case where it is difficult to consider that a start-up SME has newly commenced a new business, such as expanding an existing business or adding another line of business to the existing business (the ‘exclusion provision at issue’).

This case concerns the real estate that an auto parts manufacturing company acquired to build another factory in addition to an existing factory in the same line of business. The company which had been established in May 2017 acquired buildings and land to build the factory in September 2017 and received the acquisition tax reduction at that time. In addition, the company acquired real estate to build another auto parts manufacturing factory in March 2021 (prior to the lapse of four years). The issue in this case was whether the tax reduction provision at issue can also apply to the real estate acquired to build the additional auto parts factory (the ‘real estate in question’).

In this case, after the company filed and paid the acquisition tax on the real estate in question, it submitted an amended acquisition tax return for a refund claim with the local government authorities, asserting that the tax reduction provision at issue should apply to the real estate in question. The local government authorities rejected the refund claim, arguing that the acquisition tax should not be reduced in accordance with the exclusion provision at issue since the company constructed another factory for the purpose of expanding its existing business.

The Tax Tribunal decide against the local government authorities, ruling that the real estate in question should fall in the real estate acquired by a start-up SME within four years from

the date of incorporation which should be eligible for the acquisition tax reduction based on the following grounds: i) the exclusion provision at issue is intended to disallow the application of the acquisition tax reduction to the case where a newly established SME expands the existing business of the previous company under the appearance of a 'business start-up', such as an SME carrying on the same business as a previously closed company; ii) in this context, it is difficult to view the exclusion provision at issue as a regulation to exclude a newly established SME from the scope of qualifying start-up SMEs retroactively to the time of incorporation in case the newly established SME expands its business under its name, etc.; iii) the company in this case acquired the real estate in question for the purpose of carrying on the same line of business started at the time of its incorporation; and (iv) the local government authorities earlier treated the company as a qualifying start-up SME and allowed the company to claim the acquisition tax reduction on the real estate acquired at the time of incorporation. (*Joshim2021ji2393, 2021. 10. 19.*)

The recent decision of the Tribunal is meaningful in that it has acknowledged that a start-up SME should be eligible for the acquisition tax reduction for the real estate which it has acquired within four years from the date of its incorporation in order to carry on the same line of business as registered at the time of its incorporation, reaffirming the Tribunal's earlier decisions. (*Joshim2020ji0069, 2020. 8. 20. etc.*). In the meantime, there is an authoritative interpretation published by the Ministry of the Interior and Safety that the acquisition tax reduction cannot be applicable in case a start-up SME establishes a new business place in another location to engage in the same line of business in addition to an original business place which has obtained the acquisition tax reduction for a start-up SME. It may be necessary consider this interpretation along with the recent Tribunal decision. (*Local Tax Relief Division-1084, 2017. 5. 22.*)

### A deductibility of input VAT on professional advisory fees incurred in respect of capital increase for a VAT-able business

Article 38 (1)(1) of the Value Added Tax (VAT) Law provides that an amount of VAT on goods or services used by a company for its own business or supplied to a company for its own use shall be deducted from an amount of output VAT. Notwithstanding Article 38 (i.e. Deductible Input Tax Amount), Article 39(1)(4) of the VAT Law states that an amount of input VAT paid on expenditure which is not directly related to a company's business shall not be deducted from an output VAT amount.

The issue in this case was whether a company could claim a deduction of input VAT on fees paid by the company to a professional services firm which provided advice in relation to the company's capital increase to raise funds to finance its VAT-able business.

Regarding this, the National Tax Service (NTS) interpreted that an amount of input VAT paid on such professional fees can be deducted from the output VAT amount in case a company conducting a VAT-able business received legal and consulting advice from a professional advisory firm in the course of its capital increase to finance the expansion of its VAT-able business and investment in facilities, provided that the legal and consulting advice received is directly related to the company's VAT-able business. (*Standard-2021-Beopryeonghaeseokbuga-0112, 2021. 6. 23.*)

The recent NTS interpretation acknowledges the deductibility of input VAT on fees for professional advice on capital increase based on the determination of whether such advice is directly related to the company's business. Meanwhile, the Tax Tribunal decided in a previous case that whether financial advisory services concerning fund raising are related to the business should be determined depending on the nature of funds raised as a result of the advisory services, and as such, an input VAT on fees for financial advisory services for a company's capital increase can be deducted from its output VAT by considering the facts that funds raised through the capital increase were invested in the company's VAT-able business, etc. It may be necessary to consider the previous Tribunal decision along with the recent NTS interpretation. (*Joshim2016joong3427, 2017. 2. 14.*)

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