Government’s Bill to Amend Presidential Decrees of Tax Laws

After the government’s bill to amend 21 tax laws, including the Corporate Income Tax Law, the Special Tax Treatment Control Law, the Individual Income Tax Law, etc., passed the National Assembly on December 8, 2018, the amended tax laws were promulgated on December 24, 2018. Most of the changes contained in the amended tax laws became effective from January 1, 2019. Subsequent to the amendment of the tax laws, the Ministry of Economy and Finance (MOEF) has announced the government’s bill to amend the Presidential Decrees of the tax laws. The bill is expected to be proclaimed on February 12, 2019 after being finalized in the cabinet meeting on February 7, 2019.

Provided below is a summary of the proposed changes contained in the government’s bill to amend the Presidential Decrees.

- Corporate Income Tax Law
- Individual Income Tax Law
- Special Tax Treatment Control Law
- Value Added Tax Law
- Law for Coordination of International Tax Affairs
- Customs Act

Corporate Income Tax Law (CITL)

**Adjustment to Calculation of Interest Expense on Borrowings for DRD Purpose**

According to the dividend received deduction (DRD) rule to exempt a portion of the dividend by a holding company from its subsidiary from taxable income, the DRD amount that the holding company can claim as the exclusion from taxable income is calculated as follows:

- DRD amount = (dividend received – interest expense on borrowings*) x DRD rate
  
  * The amount of interest expense = interest expense x (sum of the daily cumulative balances of the shares owned by the holding company/sum of the cumulative balances of the total assets of the holding company).
Under the government's bill, it proposes to exclude 'shares received from the government via in-kind contributions' from the scope of 'shares owned by the holding company' in the above formula.

The change will apply to dividends received on or after the effective date of the amended Presidential Decree.

**Adjusted Scope of Deductible Bad Debt**

The write-off of doubtful accounts or bad debts that are deductible are listed under the Presidential Decree of the CITL. The government's bill proposes to adjust the list of deductible bad debts as follows:

- Deleting from the list the receivables arising from the export of goods or the provision of services in a foreign country that are exempt from an obligation to collect in accordance with the Foreign Exchange Transaction Law. This proposed change is in line with the deletion of the article on an obligation to collect such receivables under the Foreign Exchange Transactions Law.
- Newly adding to the list the receivables determined as uncollectable ones according to a judicial compromise and a ruling of recommending compromise. The proposed change will apply to the receivables for which a judicial compromise and a ruling of recommending compromise is rendered on or after the effective date of the amended Presidential Decree.

**Change to Depreciation Method for Fixed Assets Acquired in a Qualified Vertical Spin-off or In-kind Contribution**

Currently, in a qualified vertical spin-off or in-kind contribution, the fixed assets acquired by a new company set up via the spin-off or in-kind contribution must be depreciated based on the fair market value of the assets at the time of the spin-off or in-kind contribution for corporate income tax purpose. The bill proposes that the depreciation for the assets acquired via the spin-off and in-kind contribution should be made based on the book value of such assets for corporate income tax purpose. The change reflects the government's intent to prevent companies from utilizing corporate restructuring as tax planning scheme.

The proposed change will apply to a qualified spin-off or in-kind contribution occurring on or after the effective date of the amended Presidential Decree.

**Individual Income Tax Law (IITL)**

**Expanded Scope of Businesses Required to Issue Cash Payment Receipts**

Currently, certain businesses engaged in 64 prescribed business categories are required to issue cash payment receipts to customers for any transaction in cash payment of KRW100,000 or more, regardless of customers’ request for cash payment receipts. Under the government's bill, the scope of the businesses subject to the requirement to issue cash payment receipts will be expanded to include private training institutes for computer, beauty, culinary, car mechanic, stenography, speed reading, etc. Also, it will include retailers of
pharmaceutical products and medical supplies, retailers of home appliances, business to sell and maintain cemetery lots, business for funeral vehicle transportation and rental, etc.

This change will apply to the goods or services provided by affected businesses on or after January 1, 2020.

**Exception to Penalty for Failure to Issue Cash Payment Receipts**

Currently, there is a penalty for the non-compliance with the mandatory issuance of cash payment receipts in accordance with the IITL. The bill proposes to exclude from the penalty assessment on certain cash payments which can be readily identified by the National Tax Service (NTS) such as medical benefits under the Medical Care Assistant Act, motor vehicle insurance medical fees under the Guarantee of Automobile Accident Compensation Act, insurance benefits under the National Health Insurance Act, medical aid in cash or in kind under the Emergency Aid and Support Act and emergency medical service fees under the Emergency Medical Service Act.

This change will apply on or after the effective date of the amended Presidential Decree.

**Change to the Scope of Korean Sourced Income of Foreign Corporation or Non-resident**

According to Article 132 of the Presidential Decree of the CITL and Article 179 of the Presidential Decree of the IITL, where a foreign corporation or a nonresident of Korea without having a permanent establishment ("PE") in Korea earns income arising from derivatives transactions through the derivative exchange as defined under the Financial Investment Services and Capital Markets Act, such income shall not be deemed as a Korean-sourced other income of the foreign corporation or nonresident. The government’s bill proposes to add that income earned by a foreign corporation or a nonresident from over the counter derivatives transactions for risk-hedging purposes to the excluded scope of the Korean-sourced other income earned by the foreign corporation or nonresident.

Currently, the Korean sourced other income of a foreign company or nonresident of Korea (including income from donation, compensation for damages, other economic benefits relating to the operation of assets or business in Korea) is subject to 20% Korean withholding tax rate (excluding local income tax rate).

**Special Tax Treatment Control Law (STTCL)**

**Clarifying the Scope of Qualifying Contents-related R&D Expenditures**

The government’s bill proposes the two changes to clarify the scope of contents-related R&D expenditures that are eligible for the set-up of deductible tax R&D reserve and R&D tax credit as prescribed in Articles 8 and 9 of the Presidential Decree of the STTCL. The first change is to exclude the activities relating to the production of contents or system from the scope of qualifying R&D activities. The second change is to expand the scope of qualifying contents-related R&D expenditures by including the expenditures for leasing or
purchasing software creating character fonts, sound recordings and digital image, which are incurred by a qualifying dedicated R&D department.

**Eased Criteria for Tax Credits for Qualifying R&D Expenditures**

The government's bill proposes the two changes to ease criteria for the R&D tax credit relating to new growth-engine and core technologies (herein, ‘new growth engine, etc.’). Currently, the R&D tax credit can be claimed for the personal costs incurred for the R&D staffs in i) a qualifying R&D department dedicated for R&D in new growth-engine, etc., and ii) a separate team engaging in R&D concerning new growth-engine, etc. within a qualifying R&D department conducting other eligible R&D activities (herein, ‘general R&D activities’). First, under the government’s bill, with respect to the latter case, even if there is no separately operated team within the R&D department performing general R&D activities, the personal costs of the R&D staffs will qualify for the R&D tax credit on new growth-engine, etc. as long as the staff are actually dedicated to R&D in new growth-engine, etc.

Second, where samples and raw materials costs are used for both the general R&D projects and the new growth-engine related R&D projects, such costs will be allocated in the ratio of the R&D staffs engaged in the respective project in calculating the R&D tax credit for general R&D activities and new growth engine related R&D projects, respectively (details on the allocation method will be set out in the enforcement rules). Currently, the samples and raw materials used for both the R&D projects are apportioned entirely to the general R&D activities for which R&D tax credit rate is lower than that for new growth engine R&D activities.

This change will apply for the fiscal year starting on or after January 1, 2019.

**Strengthening the Post-Verification Processes for R&D Tax Credits**

According to Article 9 of the Presidential Decree of the STTCL, a company is required to submit an application form together with a statement of R&D expenditures in order to claim a R&D tax credit for eligible R&D expenditures. Under the proposal, in order to strengthen the post-verification processes for R&D tax credits, a company will be additionally required to conduct the following requirements:

- A company should prepare and retain proper documentation to substantiate that its R&D activities qualify for R&D tax credits such as research prospectus and study report (in case of general R&D activities) and research notes (in case of new growth-engine, etc. related R&D). Details on the record-keeping will be set out in the enforcement rules.
- A company should submit research prospectus and study report in order to substantiate that its R&D activities qualify for a R&D tax credit when filing an application for the R&D tax credit.

This change will become effective for the fiscal year starting on or after January 1, 2020.

**Introduction of Advance Examination Procedures for R&D Tax Credit**

The government’s bill introduces the advance examination procedures to assess whether
certain R&D expenditures are eligible for R&D tax credit. The NTS will undertake the proposed advance examination procedures for the expenditures concerning general R&D activities as well as new growth-engine, etc. related R&D activities. Details to the advance examination procedures will be set out in the NTS ordinance.

This change will apply for the fiscal year starting on or after January 1, 2020.

**Clarifying the Scope of R&D Staff Costs Eligible for R&D Tax Credit**

Companies can claim a R&D tax credit on certain personal costs (with some exceptions) of the staff dedicated to eligible R&D activities. The government’s bill suggests to clearly exclude from the scope of qualifying personal costs severance pay, severance allowance and retirement pension contributions.

**Expanded Scope of New Growth-Engine and Core Technologies for R&D Tax Credits**

Under the government’s bill, the scope of four existing categories of qualifying new growth-engine and core technology is adjusted to additionally include i) system semiconductor manufacturing technology, ii) memory semiconductor manufacturing technology, iii) 5G switch technology and iv) manufacturing technology of liquid crystal fiber of extreme performance, etc. Also, 16 new categories will be added to the list of qualifying technologies (in Appendix Table 7 of the Presidential Decree of the STTCL), including high speed and high efficiency wireless charging system technology for electric vehicles, block chain technology, quantum computer-related technology, AR device manufacturing technology, etc.

This change will become effective for the fiscal year starting on or after January 1, 2019.

**Scope of Qualifying Facility Investment for Accelerated Depreciation**

The recently amended law extends the application of an accelerated depreciation rule for the business assets of small- and medium-sized enterprises (SMEs) as well as middle-scale companies. In this regard, the government’s bill includes the following details.

- A middle-scale company refers to a company having an average sales revenue of less than KRW300 billion over the recent three fiscal years.
- Qualifying assets include fixed business assets (as prescribed in Article 28(6) of the CITL), such as machinery, equipment, tools, appliances and fixtures, vehicles, vessels and aircraft (limited to those which are directly used in the transportation or the lease business), facilities to invest in innovative growth such as facility investment to facilitate research and human resources development (as prescribed in Article 11 of the STTCL) and facility investment to facilitate the commercialization of new engine-growth and core technologies (as prescribed in Article 25-5 of the STTCL).
- A company will be allowed to depreciate qualifying assets over the useful lives as elected and reported within the range of up to 50% of their standard useful lives.

In order to benefit from accelerated depreciation, companies must acquire qualifying assets from July 1, 2018 through December 31, 2019.
Value Added Tax Law (VATL)

Expanded Scope of E-Services of Foreign Corporations or Non-resident Subject to VAT

Under the VATL, if a foreign company or a non-resident of Korea provides certain electronic services to a person (excluding the person having Korean VAT registration) in Korea via information and communication network (as defined under relevant Korean act), it shall comply with the requirements of a simplified VAT registration and VAT return filing, together with VAT payment for the provision of the electronic services. Based on the recently-revised VATL, the electronic services of a foreign company or non-resident includes cloud computing, advertising placement services and intermediation services (to be prescribed in the Presidential Decree of the VATL) on top of the game, audio/video files and electronic documents, etc. that are supplied in an electronic format through information and communication network. The government’s bill defines the scope of the intermediation services as follows:

- Intermediation services for a person to rent, use or consume goods, places, etc. in Korea
- Intermediation services for a person to trade goods or services in Korea

However, if the consideration for the intermediation services is included in the supply price for the goods, services, etc. used, consumed or traded in Korea and an importer or a Korean business entity pays VAT on the supply price including such consideration, the intermediation services would not be subject to the VAT compliance under Article 53-2 of the VATL.

This change will apply to electronic services rendered on or after July 1, 2019.

Law for Coordination of International Tax Affairs (LCITA)

New Principles for Determining Arm’s Length Price on Intangible Asset Transactions

To address the consistency with international standards on transfer pricing rules, a new rule is proposed to clarify and establish the principles for determining the arm’s length prices of the transactions involving intangibles and addressing an appropriate remuneration for the functions performed such as development, enhancement, maintenance, protection and exploitation of intangibles. Under the government’s bill, the principles of determining the arm’s length price in a cross-border intangible transaction and addressing an appropriate remuneration in the transaction will include:

- The comparable uncontrolled price (CUP) method, profit split method, valuation method (discounted future cash flows* ) would take precedence over other transfer pricing methods; and
- * In case of using a valuation method, it is necessary to rely on reasonable assumptions on expected cash flows, growth rates, discount rate, useful life of intangibles, etc.
- The companies performing the functions and assuming the relevant risks regarding the development, enhancement, maintenance, protection and exploitation of intangibles should get appropriate remuneration for the contributions they made.
The legal ownership of an intangible would not entitle for receiving an excessive remuneration in light of the functions performed regarding the development, enhancement, maintenance, protection and exploitation of intangibles.

This change will become effective for the fiscal year starting on or after the date when the amended Presidential Decree becomes effective.

Proposed Guidance on Arm’s Length Price Calculation for Hard-to-Value Intangibles

The proposed new rule will also define hard-to-value intangibles as those for which (i) no reliable comparable exists, and (ii) the economic benefit expected to be derived from the intangible is highly unascertainable. For the principles for calculating the arm’s length price of hard-to-value intangibles, the government’s bill provides that:

- If there is a significant difference between an arm’s length price according to post-valuation and a transaction price, it would be presumed that the transaction price has not been determined based on reasonable assumptions;
- The arm’s length price of transactions should be determined and adjusted based on post-valuation which should be undertaken to consider changes in transactional circumstances and economic conditions.
- However, the above principles based on the post-valuation shall not apply in circumstances where:
  i) the taxpayer satisfactorily demonstrates an evidence that the transaction price of the intangible asset is based on reasonable assumptions;
  ii) the difference between the arm’s length price based on post-valuation and the transaction price does not exceed 20% of the transaction price; or
  iii) an advance approval has been obtained according to the agreement with the tax authorities with respect to the method for determining the arm’s length price of the concerned intangible asset.

This change will become effective for the fiscal year starting on or after the date when the amended Presidential Decree is enforced.
Customs Act

New Procedures to Defer Disposition of Delinquent Customs Duties

The recently amended Customs Act introduces a new rule to defer the disposition of delinquent customs duties for taxpayers suffering from temporary liquidity problems. Details on how to apply for the deferment, etc. will be set out in the Presidential Decree as follows:

- An application must be filed with a customs office, which must include personal information on delinquent taxpayers, delinquent duty amount, deferment period and the amount as well as the number of installment payments.
- A required collateral for delinquent customs duty will be waived if a statement of payment plan (including payment schedules and specific plans, etc.) is submitted.
- The deferment will be allowed for a period up to two years.

This change will apply from the date when the amended Presidential Decree becomes effective.

New Procedures to Settle Cross-border HS Code Dispute

A new rule on the Harmonized System (HS) Code dispute settlement will be introduced in the Presidential Decree of the Customs Act to help settle cross-border disputes over the HS classification of commodities between customs authorities and persons liable for customs duty. The new rule will stipulate as follows with respect to a dispute over the HS classification of commodities arises:

- The MOEF or the Commissioner of the Customs Service shall seek consultations with relevant customs authorities in a foreign country based on the International Convention on the Harmonized Commodity Description and Coding System (in case the Commissioner of Customs Service undertakes such consultation, the facts and the occurrence of the dispute as well as the relevant consultation details shall be reported to the MOEF).
- For unresolved cross-border disputes, the MOEF shall seek resolutions of disputes by the Customs Cooperation Council.

This change will apply from the date when the amended Presidential Decree becomes effective.
## Contacts

<table>
<thead>
<tr>
<th>International Tax Services</th>
<th>Domestic Tax Services</th>
<th>Transfer Pricing &amp; International Trade</th>
<th>Nonprofit Corporation Service Center</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alex Joong-Hyun Lee 709-0598 <a href="mailto:alex.lee@pwc.com">alex.lee@pwc.com</a></td>
<td>Yeon-Gwan Oh 709-0342 <a href="mailto:yeon-gwan.oh@pwc.com">yeon-gwan.oh@pwc.com</a></td>
<td>Heui-Tae Lee 3781-9083 <a href="mailto:heui-tae.lee@pwc.com">heui-tae.lee@pwc.com</a></td>
<td>YoungSun Pyun 3781-9684 <a href="mailto:youngsun.pyun@pwc.com">youngsun.pyun@pwc.com</a></td>
</tr>
<tr>
<td>Sang-Do Lee 709-0288 <a href="mailto:sang-do.lee@pwc.com">sang-do.lee@pwc.com</a></td>
<td>Young-Sin Lee 709-4756 <a href="mailto:young-sin.lee@pwc.com">young-sin.lee@pwc.com</a></td>
<td>Henry An 3781-2594 <a href="mailto:henry.an@pwc.com">henry.an@pwc.com</a></td>
<td>Sang-Kyoong Song 3781-9675 <a href="mailto:sang-kyoong.song@pwc.com">sang-kyoong.song@pwc.com</a></td>
</tr>
<tr>
<td>Sang-Woon Kim 709-0789 <a href="mailto:sang-woon.kim@pwc.com">sang-woon.kim@pwc.com</a></td>
<td>Jin-Ho Kim 709-0661 <a href="mailto:jin-ho.kim@pwc.com">jin-ho.kim@pwc.com</a></td>
<td>Won-Yeob Chon 3781-2599 <a href="mailto:won-yeob.chon@pwc.com">won-yeob.chon@pwc.com</a></td>
<td>PwC Customs Service</td>
</tr>
<tr>
<td>Michael Kim 709-0707 <a href="mailto:michael.kim@pwc.com">michael.kim@pwc.com</a></td>
<td>Chul-Jin Hwang 709-0759 <a href="mailto:chul-jin.hwang@pwc.com">chul-jin.hwang@pwc.com</a></td>
<td>Junghwan Cho 709-8895 <a href="mailto:junghwan.cho@pwc.com">junghwan.cho@pwc.com</a></td>
<td>Young-Mo Lee 3781-3140 <a href="mailto:youngmo.lee@pwc.com">youngmo.lee@pwc.com</a></td>
</tr>
<tr>
<td>Dong-bok Lee 709-4768 <a href="mailto:dongbok.lee@pwc.com">dongbok.lee@pwc.com</a></td>
<td>Bok-Suk Jung 709-0914 <a href="mailto:boksuk.jung@pwc.com">boksuk.jung@pwc.com</a></td>
<td>M&amp;A Tax</td>
<td>Samil Infomine</td>
</tr>
<tr>
<td>Chong-Man Chung 709-4767 <a href="mailto:chong-man.chung@pwc.com">chong-man.chung@pwc.com</a></td>
<td>Hyungsuk Nam 709-0382 <a href="mailto:hyungsuk.nam@pwc.com">hyungsuk.nam@pwc.com</a></td>
<td>Min-Soo Jung 709-0638 <a href="mailto:minsoo.jung@pwc.com">minsoo.jung@pwc.com</a></td>
<td>Sang-Kyoon Song 709-0559 <a href="mailto:sang-kyoon.song@pwc.com">sang-kyoon.song@pwc.com</a></td>
</tr>
<tr>
<td>Hyun-Chang Shin 709-7904 <a href="mailto:hyun-chang.shin@pwc.com">hyun-chang.shin@pwc.com</a></td>
<td>Dong-Jin Nam 709-0656 <a href="mailto:dong-jin.nam@pwc.com">dong-jin.nam@pwc.com</a></td>
<td>Hye-Won Choi 709-0990 <a href="mailto:hyewon.choi@pwc.com">hyewon.choi@pwc.com</a></td>
<td>Global Mobility Services (GMS)</td>
</tr>
<tr>
<td>Chang-Ho Jo 3781-3264 <a href="mailto:changho.jo@pwc.com">changho.jo@pwc.com</a></td>
<td>Seungdo Na 709-4068 <a href="mailto:seungdo.na@pwc.com">seungdo.na@pwc.com</a></td>
<td>Jina Park 709-0797 <a href="mailto:jina.park@pwc.com">jina.park@pwc.com</a></td>
<td>Jina Park 709-0797 <a href="mailto:jina.park@pwc.com">jina.park@pwc.com</a></td>
</tr>
<tr>
<td>Nam-Gyo Oh 709-4754 <a href="mailto:nam-gyo.oh@pwc.com">nam-gyo.oh@pwc.com</a></td>
<td>Youngsuk Noh 709-0877 <a href="mailto:yongsuk.noh@pwc.com">yongsuk.noh@pwc.com</a></td>
<td>Inheritance &amp; Gift Tax Services</td>
<td>Inheritance &amp; Gift Tax Services</td>
</tr>
<tr>
<td>Il-Gyu Cha 3781-3173 <a href="mailto:il-gyu.cha@pwc.com">il-gyu.cha@pwc.com</a></td>
<td>Sun-Heung Jung 709-0837 <a href="mailto:sun-heung.jung@pwc.com">sun-heung.jung@pwc.com</a></td>
<td>Hyun-Jong Lee 709-6459 <a href="mailto:hyun-jong.lee@pwc.com">hyun-jong.lee@pwc.com</a></td>
<td>Hyun-Jong Lee 709-6459 <a href="mailto:hyun-jong.lee@pwc.com">hyun-jong.lee@pwc.com</a></td>
</tr>
<tr>
<td>Kwang-Soo Kim 709-4055 <a href="mailto:kwang-soo.fsis.kim@pwc.com">kwang-soo.fsis.kim@pwc.com</a></td>
<td>Sung-Wook Cho 709-8184 <a href="mailto:sung-wook.fsis.kim@pwc.com">sung-wook.fsis.kim@pwc.com</a></td>
<td>Financial Tax Services</td>
<td>Financial Tax Services</td>
</tr>
<tr>
<td>Young-Ok Kim 709-7902 <a href="mailto:young-ok.kim@pwc.com">young-ok.kim@pwc.com</a></td>
<td>Yoon-Sup Shin 709-0906 <a href="mailto:yoon-sup.shin@pwc.com">yoon-sup.shin@pwc.com</a></td>
<td>Taejin Park 709-8833 <a href="mailto:taejin.park@pwc.com">taejin.park@pwc.com</a></td>
<td>Taejin Park 709-8833 <a href="mailto:taejin.park@pwc.com">taejin.park@pwc.com</a></td>
</tr>
<tr>
<td>Robert Browell 709-8896 <a href="mailto:robert.browell@pwc.com">robert.browell@pwc.com</a></td>
<td>Yu-Chul Choi 3781-9202 <a href="mailto:yu-chul.choi@pwc.com">yu-chul.choi@pwc.com</a></td>
<td>Hoon Jung 709-3383 <a href="mailto:hoon.pj6.jung@pwc.com">hoon.pj6.jung@pwc.com</a></td>
<td>Hoon Jung 709-3383 <a href="mailto:hoon.pj6.jung@pwc.com">hoon.pj6.jung@pwc.com</a></td>
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