Korean Tax Update

Samil Commentary

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Government's Bill to Amend Presidential Decrees of Tax Laws

Following the amendment of tax laws at the end of December 2021, the Ministry of Economy and Finance (MOEF) announced the government's bill to amend the Presidential Decrees of these tax laws on January 6, 2022, inviting public comments thereon until January 20, 2022. The government's bill will be finalized in the cabinet meeting and proclaimed in February 2022. If approved, most of the proposed amendments to the Presidential Decrees would take effect from the date the amended rules are proclaimed or from the fiscal year in which the effective date falls, unless otherwise specified.

Provided below are a brief summary of the selected significant changes contained in the government's bill to amend the Presidential Decrees of the tax laws (the 'bill').

Reduction of Interest Penalty Rate for Late Payment

Under the Basic National Tax Law (BNTL), if a taxpayer fails to pay the full amount of tax owed by a statutory due date, interest penalties for late payment are imposed on the unpaid or underpaid amount of tax multiplied by the number of days from the day following the due date through to the date the taxpayer voluntarily makes the payment by applying a specified interest penalty rate. According to the bill, the interest penalty rate will be lowered from 0.025% per day (9.125% per annum) to 0.022% per day (8.030% per annum).

Additional Reasons for Request for Re-examination of the Tax Tribunal Decision

Currently, where there is an omission of material facts or an obvious error in the interpretation of laws and regulations in the hearing process of a case by the Tax Tribunal, the BNTL allows the Head of the Tax Tribunal to request a re-examination of a decision made by the council of tax judges to the chief tax judge. According to the bill, the request for re-examination would be allowed for the following additional cases where:

1) there is an obvious error in the determination of material facts;
2) results of examination by the council of tax judges are different from: i) judgements or decisions that have been made by the Supreme Court or the Constitutional Court; ii) authoritative rulings on the interpretation of tax laws that have been reviewed by the Committee for Examination of Established Rules for National Taxes; or iii) decisions deliberated in the joint session of tax judges; or

3) it takes a different approach for examining the same regulations or facts and circumstances which have been dealt with by the Tax Tribunal or courts in previous rulings.

Expanded Scope of Deductible Costs for Difference from Exercise of Stock Options

Currently, where a company grants stock options to its executives or employees whereby they hold the right to purchase the company's shares at an exercise price pre-determined at the time of grant, a compensation expense incurred by the company for the 'difference between a stock price at a time of exercise and the pre-determined exercise price' (the 'difference from the exercise of stock options') should be deductible provided certain requirements are met under the Corporate Income Tax Law (CITL). To be eligible for deduction, stock options must be granted under the special laws including the Commercial Code, the Act on Special Measures for the Promotion of Venture Businesses and the Act on Special Measures for the Promotion of Specialized Enterprises for Materials and Components. Under the bill, such deduction will also be allowed with respect to stock options granted as part of the employee stock ownership program pursuant to the Labor Welfare Framework Act. This change will be applicable to stock options exercised on or after the date the amended Presidential Decree comes into force.

Clarify Business Transfer Scope Subject to Deduction Limit of Loss Carryforward

The recently amended CITL includes a new provision that limits the deduction of existing tax losses carried forward following a business transfer in an effort to prevent tax avoidance through a business transfer where the business transfer meets certain requirements. The amended CITL allows a transferee company acquiring a transferred business to utilize and offset its existing tax losses carried forward only to the extent of income arising from its existing business if certain requirements are met. The bill clarifies that these requirements are: i) the transfer of business is made between related parties, and ii) 70% or more of the assets and 90% or more of net assets (assets minus liabilities) should be transferred to the transferee company. The amended rule will be applicable to business transfer agreements signed on or after January 1, 2022.

New Reporting Requirements for Foreign Liaison Offices

The recently amended CITL includes a new provision on reporting requirements for liaison offices of foreign corporations. The new provision requires foreign liaison offices that undertake non-sales functions in Korea to prepare specified information as of December 31st and submit it by February 10th of the following year. According to the bill, non-sales functions are defined as acting as a contact point for foreign head office, market research, R&D activities, collection of market information, etc. The required information includes: i) overview, rental status, employees and operating fund of liaison office; ii) overview, domestic transactions, domestic entities and branches, and contract agencies of its foreign head office: and iii) other matters related to the status of liaison offices as specified by an ordinance of the MOEF. The new requirement shall be applicable for fiscal years starting on or after January 1, 2022.

Expanded Scope of Appraisal Agencies for Valuation of Overseas Shares

The value of tangible property on which inheritance or gift tax is imposed shall be based on the market price, whereas the supplementary valuation method may be used if it is practically difficult to calculate or obtain the market price, according to the Inheritance and Gift Tax Law (IGTL). In addition, where it is inappropriate to use the supplementary valuation method, the value shall be based one of the following: 1) the value assessed for the purpose of imposition of capital gains tax, inheritance tax, and gift tax in the country where the property is located; or 2) the value determined based on the appraisal by two or more domestic or foreign appraisal agencies. With respect to 2), the scope of appraisal agencies will be expanded to include accounting firms, tax service firms and credit appraisal institutes for the valuation of shares in overseas companies under the bill.

Eased Requirement for Basic Deduction for Family Business Succession

Where a qualifying small and midsize enterprise (SME) or a middle-scale company makes a family business succession, the IGTL provides for basic deductions ranging from KRW20 billion to KRW50 billion depending on the duration of primary business operation (i.e., a minimum of 10 years to 30 years or more). To qualify for the basic deductions in family business succession, it must be ensured that the family business has primarily operated in any of the business categories ('subject business category') listed in the IGTL for at least 10 years. The bill will ease the requirement for operations and maintenance, so that the basic deduction could apply to a family business succession even with a change in the subject business category at the highest level of the Korean Standard Industrial Classification.

Increased Tax Incentives for National Strategic Technology

Clarified scope of National Strategic Technology eligible for R&D tax credit. Currently, qualifying R&D expenditure for new growth or source technologies is eligible for R&D tax credits at rates higher than the credit rates available for other general technologies. In addition, the recently amended Special Tax Treatment Control Law (STTCL) provides for the highest rates of tax credit (that are 10% higher than the credit rates for new growth or source technologies) for qualifying R&D expenditure incurred for any national strategic technologies prescribed in the Presidential Decree.

The bill further specifies 34 kinds of national strategic technologies in the three industrial sectors of semiconductor, secondary battery and vaccine as follows:

- (semiconductor) 20 kinds of technologies to design and manufacture 15nm or lower DRAM and 170-layer NAND flash memory;
- (secondary battery) nine kinds of technologies to manufacture parts, materials, cells, and modules of high-performance lithium secondary batteries and improve battery safety; and
- (vaccine) five kinds of technologies to discover therapeutic and preventive vaccine candidate materials and vaccine manufacturing as well as production technologies.

The amended rules shall apply to qualifying R&D expenditure for national strategic technologies incurred on or after July 1, 2021.

Defined scope of facilities to commercialise national strategic technology eligible for investment tax credit. Under the newly amended STTCL, investment in facilities to commercialize national strategic technologies will be eligible for a 3-4% higher tax credit compared to investment in facilities relating to new growth or source technologies. The bill defines the scope of facilities to commercialise national strategic technologies that includes 31 kinds of technologies in the industrial sectors of semiconductor, secondary battery and vaccine as specified in an MOEF ordinance. These will be subject to examination by the New Growth and Source Technology Review Committee as well as a joint review by the Minister of Economy and Finance and the Minister of Trade, Industry and Energy. The amended rules shall apply to investment in facilities to commercialise national strategic technologies made on or after July 1, 2021.

Expanded Scope of New Growth or Source Technology Eligible for Tax Credit

The STTCL provides for a tax credit for qualifying R&D expenditure and facility investment to develop and invest in 235 different kinds of technologies in 12 industrial sectors. The bill will expand the scope of technologies eligible for the R&D and investment tax credit to 260 different kinds of technologies in 13 industrial sectors. Specifically, the additional list of eligible technologies will include 48 kinds of carbon capture, utilization and storage (CCUS) technology as well as carbon reduction technology in the areas of hydrogen, renewable energy, industrial processes and energy efficiency and transportation; and eight kinds of technologies for high-efficiency hybrid vehicle system, bio-foundry technology, heavy rare earth elements, physical recycling of plastic wastes, etc. However, technologies for lightweight frame and LNG carrier compressors will no longer be eligible for the tax incentives.

In addition, with respect to new growth or source technologies eligible for the tax credit, the bill requires the periodic evaluation whereby the tax credit granted to each qualifying technology would be valid for up to three years from the date of selection.

Temporary Extension of Carryback Period of Tax Losses for SMEs

To support the liquidity of SMEs, the amended STTCL extends the carry-back period of tax losses for SMEs on a temporary basis and allows them to apply for a refund of the amount of tax calculated as prescribed by the Presidential Decree to the extent of income tax imposed. Under the amended STTCL, the carry-back period is extended to two years (one year before the amendment) immediately preceding the tax year in which tax losses incurred by SMEs including December 31, 2021. According to the bill, the amount of income tax eligible for a refund request by SMEs will be calculated by (1) – [(2) x (3)]:

(1) the amount of tax calculated for the immediately preceding tax year or the year before the immediately preceding tax year;
(2) the tax base for the immediately preceding tax year or the year before the immediately preceding tax year, after subtracting the amount of tax losses retroactively (*if there is tax payable in both the immediately preceding year and the year before the immediately preceding year, the tax losses shall be subtracted from the tax base for the year before the immediately preceding year); and
(3) the tax rate for the immediately preceding year or the year before the immediately preceding year.

The refund request based on the tax loss carryback must be filed with the competent tax office by the due date of tax return filing under the Individual or Corporate Income Tax Law.

Special Tax Treatment for Stock Options Granted by Venture Business Subsidiaries

Under the amended STTCL, the existing special tax treatment shall be extended to stock options granted by subsidiaries of qualifying venture businesses to their executives and employees. The special tax treatment includes non-taxation of such gains (subject to limits), instalment payment of tax payable and the tax deferral until the disposition of shares of venture business stock (from the time upon exercising). The bill defines subsidiaries of venture businesses eligible for the special tax treatment as those where a qualifying venture business has acquired 30% or more of the total number of outstanding shares, the same as the scope of subsidiaries pursuant to Article16-3 of the Act on Special Measures for the Promotion of Venture Businesses and the Act on Special Measures. The change will be applicable to stock options exercised on or after January 1, 2022, while the tax deferral shall apply to gains from the exercise of stock options on or after January 1, 2021.

Stock Options Granted at Price Lower than 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. According to the amended STTCL, the special tax treatment shall 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. To qualify for the special tax treatment for stock options granted at a price lower than the market price, the bill notes that the exercise price should be higher than the par value of the stock and exercise gains shall not exceed KRW500 million per person.

Currently, venture businesses cannot deduct the payment for the difference between the price at grant and the exercise price of stock options that benefit from the tax deferral. However, the bill will allow deduction of such payment where gains are taxed as earned payroll income of employees who would exercise the options. This proposed change will apply to stock options granted on or after January 1, 2022.

Exception Case for Transfer of Trustor's Status Not Subject to Supply of Goods

The amended Value Added Tax (VAT) law includes a new provision to clarify the VAT guidance in relation to trust property. In case of the transfer of a trustor's status to a third party pursuant to Article 10 of the Trust Act, the new provision states that it shall be regarded as the supply of goods by the original trustor to a new trustor of trust property with the exception of cases where there is no substantial change in ownership of trust property as stipulated by the Presidential Decree. The bill will make exceptions to the new provision in cases where: i) a collective investment management company transfers the status of a trustor to another collective investment management company; and ii) there is no substantial change in ownership of trust property in the above-equivalent case.

Improvement of Input VAT Deduction and VAT Invoicing Regime

(1) Generally, an input VAT deduction cannot be claimed for VAT invoices issued after a time of supply specified under the VAT Law. Even in such case, currently, the input VAT deduction will be allowed in specified cases, including where a VAT invoice is issued within six months from the date following the filing due date of a final VAT return for the half year period (i.e. January to June period or July to December period) provided that any of the following circumstances specified in the Presidential Decree occurs: i) where a taxpayer files an amended VAT returns for additional VAT payment and an amended VAT return for a VAT refund request; or ii) where the head of the competent tax office makes a decision or rectification after verifying the relevant transactional facts. The bill extends this six-month period to one year from the date following the filing due date of a final VAT return.

(2) Under the bill, an input VAT deduction would be allowed in case of VAT invoices issued before a time of supply due to an error if the time of supply arrives in six months from the issue date of VAT invoice, which is a significant extension from 30 days at present, provided that the head of the competent tax office makes a decision or rectification after verifying the relevant transactional facts.

(3) Currently, an input VAT deduction is allowed for special cases where VAT invoices are incorrectly issued due to an error in recognizing the type of transaction (e.g., treating a consignment sale of goods as a direct sale of goods or vice versa), provided that certain conditions specified under the VAT Law are satisfied. The bill will expand the scope of such special cases that: i) an arrangement, brokerage or consignment of services is mistakenly treated as a direct supply of services, or vice versa; or ii) business expenses of a consignor is mistakenly treated as those of a consignee in consignment of services, or vice versa. To qualify for input VAT deduction in those cases, it should be ensured that VAT invoices are issued and VAT is paid in a due manner in accordance with the type of transaction the transaction party has recognized.

(4) Where any requisite information (e.g., a supplier, a recipient of goods or services, supply amount, VAT invoice date) is wrongly stated in a VAT invoice due to an error, the bill extends the due date for issuing an amended VAT invoice to one year from the date following the filing due date of a final VAT return. Currently, in this case, an amended VAT invoice can be issued to correct the wrongly stated information by the filing due date of a final VAT return for the half year period in which the time of supply of goods or services falls. However, it cannot be issued where it is already known that a rectification or decision would be made by the head of the competent tax office or the tax base or the amount of tax will be rectified due to the notification of tax audit findings.

Submission Requirement for Input VAT Summary List of Foreign Liaison Office

The bill will require liaison offices of foreign corporations to submit a summary list of input VAT invoices by supplier. Currently, such requirement applies to VAT-exempt traders which should be liable to pay individual or corporate income tax, nonprofit corporations, central or local government organizations, corporations established under special laws, etc.

The new requirement will apply to foreign liaison offices to which goods or services are supplied on or after July 1, 2022.

New Transfer Pricing Guidance on Financial Transactions

Credit default swaps and economic modelling methods to determine arm's length interest rate. Where it can be hard in practice to apply any of five main methods of the Law for Coordination of International Tax Affairs (LCITA) to determine the arm's length price of financial transactions between a resident and its overseas related parties (intra-group loan), the LCITA requires the application of interest rate determined by the MOEF ordinance, taking into account the transaction amount and real interest rates in the international capital market. In the above-mentioned case, besides the existing method, the bill proposes two additional methods, noting that any of the most reasonable methods may be used to determine the arm's length interest rate. One of the two additional methods will be based on spreads of credit default swaps contracts that reflect the credit risk linked to an underlying financial asset. Another additional method will be based on the interest rate calculated by taking into account a risk-free interest rate plus a risk premium associated with different aspects of the intra-group loan including default risk, liquidity, maturity, inflation rate, etc.

Transfer pricing method for cash pooling arrangements. The bill proposes a new provision that sets forth details on transfer pricing for cash pooling arrangements as summarized below. The proposed new provision is to align with some matters addressed in the OECD guidance on the transfer pricing aspects of cash pools.

- Cash pooling can be used for a multinational group's liquidity management where individual cash accounts of companies of a multinational group (i.e. overseas related parties subject to the transfer pricing rules under the LCITA) are managed on a consolidated basis in any of the following ways:
  1) Holding a so-called master account in a multinational group: In this situation, the participating group companies transfer or receive funds through the master account.
  2) Managing liquidity without a master account: In this situation, a third party bank which the group has concluded an arrangement manages the group's liquidity position based on the total outstanding balance of group companies' accounts and makes interest payments and collections.

- The arm's length prices in relation to cash pooling arrangements will be determined in the order of 1) and 2)
  1) (Renumeration for cash pool leader) Using the method to determine the arm's length principle applicable to service transactions or borrowing or lending of money by taking into account the functions performed, the risks assumed, and the assets used. The cash pool leader would be a group company in charge of cash pool arrangements.
  2) (Renumeration for cash pool participants) Applying the arm's length interest rate when participating in a cash pool. If a master account is not available, it should be determined by proportionally considering expected benefits to the cash pool participants such as a reduction of interest expense stemming from the participation in cash pooling arrangements.

The proposed change will be applicable to financial transactions made from the fiscal year in which the enforcement date of the amended Presidential Decree falls.

Selection of Loss-making Comparables

For the practical application of transfer pricing rules under the unique economic challenges posed by the COVID-19 pandemic, the bill proposes a new provision to provide a legal framework to permit the selection of loss-making comparables for the application of methods to calculate the arm's length price. The proposed new provision indicates that companies that suffer losses in periods affected by the COVID-19 pandemic may be considered for the comparability analysis and selected as comparables where reliability can be demonstrated. This is to reflect some of the issues addressed by the OECD Guidance on the Transfer Pricing Implications of the COVID-19 Pandemic..

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