Tax News Flash

Korea’s Tax Reform Proposals for 2018

July 31, 2018

In brief

On July 30, the Ministry of Strategy and Finance (MOSF) announced the government’s tax reform proposals for 2018. The reform proposals confirm the government’s commitment to drive tax policies and regimes to facilitate job creations as well as innovative growth and narrow the income inequality. They also include proposed changes to embrace the BEPS (base erosion and profit sharing) initiatives taken by the OECD. The government’s proposal package will be finalized through public hearings in the cabinet meeting on August 28, 2018 before being submitted to the National Assembly at the end of August. If finalized, most of the proposed changes will take into effect from January 1, 2019 or the fiscal year beginning on or after January 1, 2019 unless otherwise be specified.

Provided below is a summary of significant changes contained in the government’s reform proposals.

In detail

Corporate Income Tax Law

Proposed Changes in respect of PE of a Foreign Company in Korea

The latest reform proposal include two significant changes in respect of permanent establishment (PE) of a foreign company in Korea. One of the proposed changes strengthens the criteria for exemptions of specific activities from the PE status. Currently, according to Article 94 (4) of the CITL, the PE of a foreign company in Korea shall not include:

1) Place used by a foreign company solely for the purpose of purchase of assets;

2) Place used by a foreign company solely for the purpose of storage and holding of assets not for sale;

3) Place used by other persons solely for the purpose of processing a foreign company’s own assets; and

4) Place used by a foreign company solely for the purpose of carrying on any other activity of a preparatory or auxiliary character such as advertisement, market research, etc.
Under the proposed change, the places listed above in 1), 2) and 3) would be exempted from the definition of PE only if the specific activity carried on at the place is of a preparatory or auxiliary character. This represents the government’s intent to reflect the changes to the OECD Model Tax Convention in November 2017 in line with the OECD BEPS initiatives.

A new rule is also proposed to avoid the abuse of PE exemptions for specific activities which are of a preparatory or auxiliary character. According to the proposed new rule, even if specific activities carried on by a foreign company at a specific place are of a preparatory and auxiliary character, the aforementioned specific place would be deemed to constitute a PE if any of the following situations exists:

1) If the foreign company or its related party maintains a domestic place of business at the same place where the specific place exists or at a different place in Korea, and the activities carried on by the same foreign company or its related party at the specific place constitute the complementary functions to the business activities of the domestic place of business of the foreign company or its related party; or

2) If the overall activity resulting from the combination of activities carried on by the foreign company or its related party at each fragmented specific place is not of a preparatory or auxiliary character.

**Expanded Scope of Dependent Agent**

Two significant changes are proposed to expand the scope of dependent agent and clarify the types of contracts to determine the dependent agent status. Currently, a dependent agent would exist when the agent has and habitually exercises an authority to conclude a contract on behalf of a foreign company. Under a proposal, it is expanded to include situations where: i) an agent having no authority to conclude contracts on behalf of a foreign company repeatedly plays a principal role in the course of concluding contracts; and ii) contracts are routinely concluded without modification to material elements of contracts by the foreign company.

Currently, there is no specific provision on the type of contracts considered testing a dependent agent status. According to a proposed new provision, a foreign company would be deemed to have a dependent agent if: i) contracts are concluded in the name of a foreign company; ii) contracts are concluded to transfer the title to assets owned by a foreign company or grant the right to use assets owned by a foreign company; or iii) contracts are concluded to provide services of a foreign company.

**Expansion of Tax Credit and Carryover Period for Contributions**

To promote social contribution activities, changes are proposed to expand the existing tax credit for contributions. Currently, an individual taxpayer is entitled to a 15% tax credit on the first contribution worth KRW20 million or less and a 30% tax credit on the contribution amount in excess of KRW20 million. According to proposed changes, a 15% tax credit will be granted to the first contribution of KRW10 million and a 30% tax credit to the contribution amount in excess of KRW10 million. In addition, currently, the amount contributed by an individual or corporate taxpayer in excess of a deductible limit prescribed under the tax laws is carried forward to the five (5) succeeding taxable years. Under the proposal, the carryover period will be extended from 5 years to 10 years.

**Strengthened Reporting Requirement for Overseas Real Estate and Overseas Direct Investment**

Where a Korean individual resident or a domestic company acquires or invests in (including lease) any foreign real estate, it must report such acquisition or investment to the tax authorities by reporting due date (e.g., within 3 months from the end of a fiscal year for a domestic company). According to a proposal, the reporting requirement would also
apply to the disposal of foreign real estate. In addition, the proposal added new thresholds for foreign real estate subject to reporting requirement: KRW200 million or more in acquisition value for acquisition or investment, and KRW200 million or more in disposal value for disposal.

Where a Korean resident or a domestic company fails to comply with the reporting requirement or files false information on the acquisition or investment income of foreign real estate, the following penalties would be imposed:

- 10% of the acquisition value or investment (or lease) income for the failure to report the acquisition or investment (lease) income, up from 1% of such value or income at present;
- 10% of the disposal value for the failure to report the disposal of foreign real estate subject to the reporting requirement;
- The penalties would be capped at KRW100 million, up from KRW 50 million at present.

Please note that the proposed increase in penalties would apply to filings of the acquisition, investment or disposal of foreign real estate for tax years beginning on or after January 1, 2020.

Where a Korean individual resident or a domestic company makes overseas direct investment, the Korean individual resident or the domestic company should submit the required documents prescribed under the tax laws to the tax authorities. The required documents include: a list of overseas subsidiaries, a financial status table of overseas subsidiaries, a loss statement and a status table of overseas sales offices. Currently, a penalty of KRW5 million per document (KRW3 million per document for individual taxpayer) shall apply for the failure to submit any of the first three documents except the status table of overseas sales offices. Under a proposal, such penalty would also be imposed for the failure to submit the status table of overseas sales offices to the tax authorities. In addition, the penalty amount per document would increase from KRW5 million to KRW10 million (from KRW3 million to KRW5 million for individual taxpayer) while the total penalties continue to be capped at KRW50 million a year.

Proposed Change in Dividend Received Deduction Bracket

Where holding companies receive dividends distributed by their subsidiaries, the holding companies are allowed to deduct a certain percentage of the dividend income received from the subsidiaries (DRD), depending on their ownerships in the subsidiaries paying dividends. A change is proposed to the DRD rate bracket as presented in the table below.

<table>
<thead>
<tr>
<th>Ownership of Holding Company</th>
<th>Current DRD</th>
<th>Proposed DRD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed subsidiary</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than 40% to 100%</td>
<td>100%</td>
<td>More than 40% to 100%</td>
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<tr>
<td>20% to 40% or less</td>
<td>80%</td>
<td>30%</td>
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<tr>
<td>Less than 20%</td>
<td>30%</td>
<td>Less than 20%</td>
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<tr>
<td>Unlisted subsidiary</td>
<td></td>
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<tr>
<td>More than 80% to 100%</td>
<td>100%</td>
<td>More than 80% to 100%</td>
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<tr>
<td>40% to 80% or less</td>
<td>80%</td>
<td>50% to 80%</td>
</tr>
<tr>
<td>Less than 40%</td>
<td>30%</td>
<td>40% to 50%</td>
</tr>
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Reduction in Tax Loss to be utilized

The tax law currently allows tax losses to be carried forward for the following ten years with certain limits. Tax losses to be utilized in a year by a consolidated entity would be lowered from 80% to 60% of the taxable income attributed to the entity in that year. Also, the carryforward threshold for tax losses of a foreign company would also be lowered from 80% to 60% of the foreign company’s taxable income to enhance the fair taxation between domestic and foreign corporations.
Proposed Changes in respect of Taxation of Korean Source Income of Overseas Investment Vehicles

The government’s reform proposals include three significant changes to improve the scheme for taxing Korean source income of overseas investment vehicles (OIV).

Firstly, a change is proposed to adjust the scope of foreign corporation under the Corporate Income Tax Law (CITL). According to the current definition of foreign corporation under the CITL, an organization (e.g., OIV) is deemed as a foreign corporation if any of the following criteria is met:

1. Endowed with a legal personality pursuant to the law of the country in which it was incorporated;
2. Only comprised of partners with limited liability
3. A domestic organization, whose type of business is the same as, or similar to, the type of business of such foreign organization, is defined as a corporation under the Korean Commercial Code or any other Korean laws; or
4. Own an asset, becomes a party to a lawsuit, or directly holds a right or owes an obligation, independent of its members.

As such, under the current definition of the foreign corporation, OIVs would be deemed as foreign corporations in most cases due to the fourth criterion above based on whether to bear the rights and obligations although they are not treated as legal corporation in accordance with laws of their country of residence. In order to rectify such discrepancy, it is proposed to remove the fourth criterion while the first three criteria would remain the same in determining a foreign corporation.

Secondly, a change is proposed to clarify taxation of an OIV which is not treated as a corporation. Currently, Korean source income earned by OIV is taxed at each investor level as if they were engaged in a joint business if any of the following criteria is met: i) there is the pre-determined method or ratio for profit distribution among investors; or ii) it is confirmed that profits are in fact distributed to investors. The proposal further clarifies that Korean source income earned by OIV would be taxed at each investor level according to types of income. In this connection, it is also proposed that where a list of investors is partially disclosed, only the portion of the Korean source income of the OIV would be taxed at such disclosed investor level. In addition, in case of the taxation at the investor level, the CITL (rather than the Individual Income Tax Law) would apply to an investor which is a corporation.

Thirdly, a new provision is proposed to address situations where an OIV should be deemed as the beneficial owner of Korean source income, provided that any of the three conditions described below are met. Please note that where an OIV is not treated as a corporation, only the last two conditions in 2) and 3) would apply.

1) An OIV shall bear tax liabilities in the country of residence of that OIV, and the OIV shall not be established with the purpose of unfairly reducing the individual income tax or corporate income tax on Korean source income;
2) An OIV does not provide a list of investors (it will be limited to the undisclosed investors in case a list of investors is partially disclosed); Note that even if an OIV is regarded as the beneficial owner, it will be taxed according to the domestic tax laws (and will not be eligible for benefits of the income tax treaty between Korea and the OIV’s country of residence);
3) An OIV is recognized as the beneficial owner in accordance with an applicable income tax treaty

The new proposed changes in respect of OIV will be applicable from the fiscal year beginning on or after January 1, 2020.

Increase in Deductible Entertainment Expenses Disbursed by SMEs

Companies are allowed to deduct a certain amount of entertainment expenditures as calculated in the prescribed formula in the tax law. In addition to the deduction limits, SMEs are temporarily allowed to take an additional deduction of KRW18 million
under the CITL (KRW24 million under the STTCL) until the end of December 2018. According to a proposal, the additional deduction under the CITL would increase to KRW24 million while the underlying provision of STTCL would be deleted. In addition, the sunset clause on the additional limit would be deleted.

**New Penalty on Receiving False Cash Receipts, etc.**

A new penalty in respect of false cash receipts, etc. is proposed. When a company receives cash receipts, credit card sales slips, etc. provided in the absence of underlying goods or services, penalties equal to 2% the amount on the receipts or slips would be imposed.

**Special Tax Treatment Control Law**

**New 10% Tax Credit Proposed for Profit Sharing**

The government’s reform proposals include a 10% new tax credit for small and midsize enterprises (SME) that share their profit with their employees. Under the proposal, SMEs that share or agree to share their profits with their employees according to Article 27-2 of the Special Act on Support for Human Resources of SMEs would get a three-year tax credit equal to 10% of the amount they share with their employees (except executive officers and employees earning annual gross salary of KRW70 million or more). The three-year tax credit will apply from January 1, 2019 through December 31, 2021. However, the new proposed tax credit would not apply to those SMES which receive the existing tax credit for payroll increase (a tax credit on the excess of the payroll during a current year over the average payroll for the preceding three years).

The proposal would also allow a tax exemption equal to 50% of payroll taxes on payments made by qualifying SMEs to their employees under such profit sharing scheme. However, the proposed new tax credit would not be available to executive officers and employees earning annual gross salary of KRW70 million or more.

**Crypto Assets to Be Excluded from the Applicable Scope of Special Tax Reduction**

The Special Tax Treatment Control Law (STTCL) provides for a 50% to 100% reduction in individual or corporate income tax for the first five years for SME that starts a business in any of 31 specified categories of businesses including manufacturing. The tax reduction would not apply to the trade or brokerage of crypto assets such as virtual currencies. In addition, the trade or brokerage of crypto assets would be excluded from the applicable scope of a special tax reduction. Currently, SMEs engaged in any of 46 specified categories of businesses including manufacturing are entitled to a 5% to 30% reduction in individual or corporate income tax, depending of the size, location and business line.

**Clarified Criterion to Exclude Special Tax Treatment for Relocation of Factory or Head Office**

A qualifying company relocating its head office or factory to a non-metropolitan area is entitled to 100% to 50% reduction in corporate income tax if it satisfies conditions prescribed in Article 63-2 of the STTCL. According to one of the conditions, even after the relocation of a factory or a head office, the business operating in the relocated factory or head office should be the same as the previous business. Under a proposal, the tax exemption or reduction would not apply to the business which a qualifying company takes over through a business transfer (i.e., M&A, spin-off, split-off, business transfer) after the relocation takes place, regardless of whether it continues to engage in the same business as the previous one.
Special Tax Treatment of Technology Transfer

SMEs and certain middle-scale companies are entitled to a 50% reduction in individual or corporate income tax on income arising from the transfer of their technology and patents, etc. as a result of their own research and development (25% on income arising from leasing technology) no later than the end of December 2018. The tax reduction would be extended by three additional years until the end of December 2021. Where SMEs acquire technology or patents, etc. from Korean nationals no later than the end of December 2018, the SMEs are eligible for a tax credit at the amount equal to 5% of the acquisition cost (10% for SMEs). This tax credit would be terminated as scheduled.

Termination of Tax Credit for Third-Party Outsourcing Logistics

The existing temporary tax credit for third-party outsourcing logistics would be terminated as scheduled at the end of December 2018. Currently, if a manufacturing company’s third-party outsourcing costs exceeds 30% or more of its total logistics costs for the respective business year and the percentage share of third-party outsourcing costs to total logistics costs does not fall below that of the preceding year, a tax credit on third party logistics expenditure shall be calculated at 3% (5% for SMEs) of the incremental amount of logistics cost over the preceding year, which shall be capped at 10% of the company’s corporate income tax for the concerned year.

New Proposed Tax Exemption or Reduction to Help Start-ups in Designated Areas of Economic Crisis

The government’s reform proposals include tax exemption and reduction to help startup SMEs in nine designated areas in severe employment or industrial contraction including Gunsan, Jeonbuk and Geoje, Kyungnam. Under a proposal, where a company engaged in any of 31 categories of industries incorporate a startup in any of designate areas in severe employment or industrial contraction would be entitled to 100% exemption from individual or corporate income tax for the first five taxable years. There would be no limits on the proposed exemptions for SMEs. For middle-scale and large corporations, the proposed tax exemptions would be limited not to exceed the amount calculated as follows: 50% of the amount of accumulated investment + the number of full-time employees x KRW15 million (KRW20 million for youth employment). In addition, the minimum alternative tax would not apply to help startups incorporated in such area no later than December 31, 2021.

Expanded Scope and Extension of Tax Benefits for Companies Returning to Korea

Currently, if certain requirements are met, SMEs and mid-scale companies receive the corporate income tax exemption for the first three years and a 50% tax reduction for two subsequent years when they return to Korea for the relocation or downsizing of their overseas businesses or operations, etc. as prescribed in Article 104-24 of the STTCL. Under a proposal, large companies returning to Korea would also enjoy the tax incentives for the relocation or downsizing of their overseas businesses or operations, etc. In addition, the tax exemptions and reductions for companies returning to Korea will be available until the end of December 2021, a three-year extension from the end of December 2018.

New Accelerated Depreciation Proposed for Facility Investment to Promote Innovative Growth

A new rule is proposed to allow an accelerated appreciation of qualifying assets invested by companies to facilitate innovative growth. According to the new proposed rule, companies would depreciate qualifying assets at a 50% faster rate in their useful lives. They would include R&D facilities, facilities designed to help the commercialization of new-growth technology, and others to be set forth by
the Presidential Decree of the Tax Law. The proposed accelerated depreciation would be applicable to facilities acquired from July 1, 2018.

**Tax Credit for R&D Expenditure and Facility Investment for Commercialization of New Growth-Engine and Core Technologies**

Currently, companies are eligible for a tax credit in respect of R&D expenditures and facility investment designed to promote the commercialization of 157 designated categories of new growth-engine and core technologies. A change is proposed to expand the scope of technologies eligible for the tax credit which would include blockchain, quantum computer-related technology and others to be set forth in the Presidential Decree of the tax law. Another proposed change would extend the tax credit until the end of December 2021, a three-year extension from the end of December 2018.

**Eased Criteria for Tax Credit in respect of Investment in the Commercialization of New Growth-Engine and Core Technologies**

In order to enjoy a 5% to 10% tax credit in respect of investment in facilities designed to promote the commercialization of new growth-engine or core technology, the following requirements must be met: i) the R&D expenditures must account for at least 5% of a company’s revenue for the immediately preceding year; ii) the R&D expenditures for the new growth-engine and core technologies must account for at least 10% of a company’s total R&D expenditures during the immediately preceding year (or a company must own a patent on the underlying technology); and iii) the number of full-time employees must not decrease from the preceding year. According to a proposal, the 5% threshold for R&D expenditures would be eased to 2%, while the investment for the first year of a new company would be tested based on the concerned year in respect of the requirements in i) and ii).

In addition, the investment tax credit would be extended until the end of December 2021, a three-year extension from the end of December 2018.

**Expanded Income Tax Exemption for Qualifying Foreign Engineers**

Under a proposal, 50% of wages received by qualifying foreign technicians and engineers as specified in the Enforcement Decree would be exempt from income tax for five years from the date when they start to render services in Korea. Currently, the income tax exemption is provided for two years. The qualifying scope remains the same and includes foreign technicians and engineers providing services under technology inducement agreements and research staff working in qualifying R&D centers of foreign-invested companies in Korea. In order to qualify for the income tax exemption, the R&D centers must: i) run their own R&D facilities; and ii) have at least five research staffs; iii) invest at least KRW100 million in R&D facilities; and iv) have at least 30% foreign ownership. In addition, the income tax exemption would be available until the end of December 2021, a three-year extension from the end of December 2018.

**Abolishment of Individual and Corporate Tax Exemptions for Foreign Direct Investment**

The latest reform proposals would abolish the existing individual or corporate income tax exemptions and reductions for foreign-invested companies in Korea as the government intends to embrace the BEPS initiatives taken by the OECD. They include 100% exemption from individual or corporate income tax for the first five years and a 50% reduction in such taxes for the following two years in proportion to the foreign shareholding ratio for foreign-invested companies that engage in certain qualified high-technology businesses and foreign investors in specially designated areas such as foreign investment zones, free economic zones, free trade zones and strategic industrial complexes exclusively developed for foreign invested companies.
However, the existing local tax and indirect tax incentives will be sustained for qualifying foreign investors. They will continue to enjoy the exemption from local taxes such as the acquisition tax and the property tax on the property acquired and owned for up to 15 years as well as the exemption from customs duties, VAT, and individual consumption tax on imported capital goods.

**Extension of Special Tax Treatment for Foreign Workers**

Foreign workers working in Korea may elect a flat income tax rate of 19% (rather than a progressive income tax rate with the highest marginal tax rate) for five years from the date they start working in Korea. This flat tax rate is supposed to apply for those who start to work in Korea by the end of December 2018. It is proposed to extend this flat tax rate until the end of December 2021.

**Law for Coordination of International Tax Affairs**

**Strengthened Requirement for Foreign Financial Account Reporting**

According to the Law for Coordination of International Tax Affairs (LCITA), Korean residents (including a domestic company) holding overseas financial accounts of which balance as of any month end date during a year exceeds a specified threshold (i.e., KRW500 million) must report to the tax authorities of the information on such accounts including the name of the account holder, the account number, the name of the financial institution, etc. by the end of June of the following year. The following changes are proposed to strengthen the administration of overseas tax revenue sources and the prevention of overseas tax evasion.

- **Expanded scope of actual owner**: The actual owner means the person who in fact manages the account by assuming economic risks relating to the transactions involving the account, obtaining benefits such as interest or dividend, holding the right to dispose of the account, etc. Currently, the domestic company owning directly or indirectly 100% shares in a foreign company having a foreign financial account is included in the scope of the actual owner if the foreign company is based in a country having no income tax treaty with Korea. Under a proposal, on top of such domestic company, an individual resident would be included in the scope of actual owner if the resident owns directly or indirectly 100% shares in the foreign company located in a country having no income tax treaty with Korea. Also, the shares in a foreign company owned by a related party to a domestic company or individual resident would be considered in determining whether 100% shares in a foreign company is directly or indirectly owned.

- **Expanded scope of person subject to explanation request**: For the failure to comply with the reporting requirement on a foreign financial account, the tax authorities can require an individual to explain the source of funds for the account in 90 days from the date of the explanation request. Under a proposal, a company would also be subject to the explanation request if it fails to comply with the reporting requirement. There would be fine at 20% of the unexplained amount or falsely explained amount.

- **Application of fine and criminal punishment for non-compliance**: Depending on the amount of non- or under-reported foreign financial account, there shall be the fine at 10%~20% of the amount of non- or under-reported account. If the amount of non- or under-reported financial account exceeds KRW 5 billion, there shall be criminal punishment such as the penalty up to 20% of such balance or an...
imprisonment of two or less years. Currently, if a criminal punishment is imposed, the entire fine amount is cancelled. However, under a proposal, if a criminal penalty is less than the fine for the non-compliance with the reporting requirement, the criminal penalty would be cancelled.

**Mandatory Public Disclosure of MAP Results**

Currently, if mutual agreement procedure (MAP) is concluded, the Minister at the Ministry of Strategy and Finance (MOSF) or the Commissioner at the National Tax Service is required to notify the tax authorities, a local government, the Director of the Tax Tribunal, other concerned authorities, and the applicant for the MAP commencement of the MAP results within 15 days from the date following the MAP closing date. Under a proposal, there would be a requirement for a mandatory public disclosure if MAP agreements are related with the application and interpretation of an applicable tax treaty.

**Deletion of Article 28 of LICITA**

Article 28 of the LICITA provides that concerning the income classification of Korean sourced income of a non-resident or a foreign corporation, a tax treaty shall take precedence despite the relevant provisions of Article 93 of the CITL and Article 119 of the IITL. Article 28 is proposed to be deleted to resolve controversies over the application and interpretation of Article 28 with reference to the Supreme Court decision interpreting that the income classification under a tax treaty shall not determine the income classification under the domestic tax laws, but it shall has priority only to the determination of the taxability at a source country and an applicable treaty rate.

**Individual Income Tax Law**

**Expanded Scope and Progressive Rates for ‘Exit Tax’**

When a Korean resident as a large shareholder expatriates from Korea for reasons of immigration to a foreign country, etc. and satisfies certain conditions, a 20% ‘exit tax’ is levied on the unrealized capital gains on the Korean shares held by the large shareholder as if the shares were sold on the day of the immigration, etc. The exit tax has not applied to real property rich shares. Under a proposal, the exit tax would apply to the shares in a real estate-rich corporation where at least 50% of the assets is composed of real estate (80% for golf course, ski resort business, etc.). Also, instead of the current flat tax rate at 20%, progressive rates for exit tax are proposed at 20% on the tax base of KRW300 million or less and 25% on the tax base exceeding KRW300 million.

In addition, a new penalty is proposed for the failure to report shareholdings to a tax office no later than the day before the expatriation from Korea. The proposed penalty for the failure to report shareholdings or underreporting would be 2% of the face value of the underlying shares. Moreover, under a proposal, the reporting requirement would apply to the shareholdings as at the day before the expatriation date rather than the end of the preceding year.

**Value Added Tax Law**

**Expanded Scope for Electronic Services Subject to VAT**

If a foreign company or a nonresident provides electronic services to private customers in Korea, it should comply with a simplified VAT registration and VAT return filing, together with VAT payment for the provision of electronic services. Currently, electronic services include software such as game, audio and video files, electronic documents, etc. that
are supplied in an electronic format through information and communication network. Under a proposal, the scope of electronic services would be expanded to cloud computing for the purpose of achieving the fair taxation between foreign and domestic companies. The proposal would apply to cloud computing services provided on or after July 1, 2019.

**Expanded Scope of Deemed Supply of Goods**

Certain deemed supply of the goods manufactured or merchandised by a taxpayer (e.g., consumption of the goods for VAT exempt business) would be subject to VAT if i) input VAT incurred for the goods has been claimed as a deduction against the taxpayer’s output VAT and ii) in case of the goods acquired through a business transfer, the input VAT for such goods has been claimed as a deduction by a business transferor. According to a proposal, the goods purchased at zero rated VAT which are treated as an exportation of goods would fall under the scope of deemed supply subject to VAT.

**Basic National Tax Law**

**Extended Statute of Limitations on Tax Assessment for Cross-border Transactions**

With respect to international transactions between a resident and a nonresident of Korea, the statute of limitation on assessment of national taxes ranges from five years to 15 years (i.e. five years for underreporting, seven years for non-filing and 15 years for tax evasion by fraudulent act). Under a proposal, a new term ‘cross-order transaction’ would be introduced to cover the international transaction and the transaction between residents involving foreign assets and services and for the cross-border transactions, the statute of limitation for tax assessment would increase to 10 years for underreporting or non-filing while there would be no change to 15 year statute of limitation in case of tax evasion by fraudulent act.

**New Requirement for Pre-Assessment Notice**

Under a proposal, it would be codified that the tax authorities must give a pre-assessment notice to a taxpayer prior to the tax assessment in cases where i) deficient tax would be assessed according to the result of tax audit; ii) a tax assessment would be made as a result of the internal review of a regional office of the NTS or the NTS concerning the work done by a district tax offices or regional tax office; iii) a tax assessment would be made based on the tax information for persons other than the taxpayer subject to a tax audit, which has been identified during the audit on the taxpayer; and iv) a tax assessment amount would be KRW 1 million or more (except the case where a tax assessment is made based on a correction order by the Board of Audit and Inspection and an explanation request is made).

**Proposed Audio Recording during Tax Audit**

Under a proposal, a tax auditor and a taxpayer would be allowed to have an audio recording during tax audit. If a tax auditor intends to have an audio recording, the auditor should notify the taxpayer of the audio recording in advance. Also, a tax auditor should provide the audio recording file to a taxpayer if requested by the taxpayer.

Currently, a tax auditor is required to provide a written notification for tax audit results to a taxpayer when the audit on the taxpayer is completed. The written notification requirement has been exempt for a taxpayer's business closing, uncertainties in address or residence of a taxpayer, etc. However, under a proposal, the notification requirement would not be exempt for business closing.

**Comprehensive Real Estate Tax Law**

**Reform of Comprehensive Real Estate Tax**

Under the proposed reform of comprehensive real estate tax, the tax base and the tax rate would steadily increase. The tax base for comprehensive real estate
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tax shall be determined by multiplying the announced real estate price after deducting necessary expenses by a fair market value ratio. Under a proposal, the fair market value ratio is proposed to increase from 80% at present to 85% in 2019 and 90% in 2020.

In addition, the rates for comprehensive real estate tax which currently ranges from 0.75% to 2% in case of a residential house for which tax base exceeds KRW 600 million depending on tax base are proposed to increase to the following rates: (i) 0.85% to 2.5% for a taxpayer owning two or less residential houses and (ii) 1.15% to 2.8% for a taxpayer owning at least three residential houses. In addition, the tax rates levied at between 0.75% and 2% for vacant or unspecified-use land subject to aggregate taxation would increase to 1% to 3%. However, no change is proposed to the tax rates levied at between 0.55 and 0.7% for land used for stores, factories, logistics facilities, etc.

Other Proposed Changes

Expanded Scope for Advance Customs Valuation Agreement

According to the Customs Act, a taxpayer may apply for advance customs valuation agreement (‘ACVA’) to agree with a customs office a method to determine customs base. Currently, the scope for which ACVA can be applied differs depending on whether there is a special relationship between a foreign seller and a domestic purchaser. Specifically, while ACVA can be applied only for the review of the reasonableness of transaction price if there exists a special relationship, it can be applied for the review of all the matters (including reasonableness of transaction price) regarding the determination of transaction price if there is no special relationship. However, under a proposal, the scope for which ACVA can be applied would be the same regardless of whether there exists a special relationship between a foreign seller and a domestic purchaser. In addition, under a proposal, if a taxpayer has an objection against the ACVA results, it would be allowed to file a request for re-examination regardless of the special relationship between a foreign seller and the domestic purchaser (currently, it is allowed unless there is a special relationship between them).

Documentation to Determine Customs Value in Related Party Transactions

Where underlying documents to determine the customs value for imported goods in related party transactions are not submitted, in general, the customs value shall be currently determined based on the declared value of the goods plus relevant expenses. Under a proposal, it would be a general rule to determine the customs value based on the prices of goods of the same type or nature or goods similar to the declared goods. In this case, the customs authorities would be required to discuss price determination methods with a taxpayer and give the taxpayer an opportunity to present its opinion prior to the price determination. However, if a taxpayer provides objective evidential data to prove practices of determining the arm’s length prices of goods, the customs value of the goods would be based on declared prices.

Proposed Changes to Deemed Gift Rules for Nominal Owner

According to the Inheritance and Gift Tax Law (‘IGTL’), in case where there is a difference between the person having a legal title to a property (‘nominal owner’) and the actual owner of the property, the property shall be deemed to be gifted to the nominal owner as of the date on which the property is registered in the name of the nominal owner and so, the nominal owner shall be liable to pay gift tax (‘the rule for deemed gift treatment on nominal owner’). Under a proposal, the actual owner rather than the nominal owner would be liable to pay the gift tax in this case. It is also proposed to delete the existing provision under the IGTL that a donor shall have a joint and several liability to pay the deemed gift tax in applicable cases. Instead, a new provision is proposed to allow the collection of delinquent
deemed gift tax against the property registered in the name of nominal owner in case there is a shortage of tax payment although an administrative disposition has been undertaken against other property of the actual owner in order to force the payment of delinquent tax.

**Proposed Changes to Penalties, etc. for Tax Payment and Tax Invoices**

Several changes are proposed to improve penalty schemes to improve taxpayer convenience and rights.

- Interest penalty for non- or under-paid tax or over-refunded tax would be lowered from 0.03% to 0.025% per day. The penalty for the failure to withhold tax would be computed at 3% of unpaid withholding tax plus 0.025% per day which would be lowered from 0.03% per day.

- If the amount of assessed taxes is not fully paid by the due date, a charge shall be accrued at the rate of 3% of the amount of the delinquent taxes after the lapse of the due date and then, additional charge shall be accrued at the rate of 1.2% of the amount of the delinquent taxes for each month. Under a proposal, the additional charge rate would lowered from 1.2% to 0.75%.

- New sanctions would be proposed against the non-compliance with the tax invoice requirements including the failure to issue tax invoices (in Korean, ‘계산서’), the issuance of false tax invoices, the failure to receive invoices, the receipt of false tax invoices and the submission of a false summary of tax invoices. The sanctions would include the imprisonment up to one year or the fine not exceeding the two times the 10% of the supply price or sales/purchase amount.

- The penalty for the failure to file credit card sales slips, etc. would be lowered from 1% to 0.5% of the supply price. The penalty for the failure to transmit electronic VAT invoices to the NTS would be lowered from 1% to 0.5% while the penalty for the delayed transmission is lowered from 0.5% to 0.3%.

- Penalty for non-compliance with the cash receipt requirement would be lowered from 50% to 30% of the transaction amount according to the IITL or CITL rather than the Act for Punishment of Tax Offenses. If 20% penalty for the non-compliance is imposed, the penalty for the rejection to issue cash receipt or the issuance of incorrect cash receipt (imposed at the rate of 5% of related transaction amount) would not be applicable.
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