Yulchon Legal Update

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2022 Korean Tax Law Amendment Proposal - International Taxation

The Ministry of Economy and Finance announced a tax law proposal late July. The proposal is subject to approval by the National Assembly (Korean parliament). Although we expect many of the proposed changes to the existing tax rules and introduction of new rules to be approved by the National Assembly, it is rather uncertain whether certain proposals (e.g., reduction of the corporate income tax rate) will be approved in their current form. Accordingly, we need to closely monitor the developments of legislative process. We have summarized some of the key proposals having an impact on global multinationals having operations in Korea.

1. Reduction of corporate income tax rate and tax brackets (Amendment of the Corporate Income Tax Act ("CITA") § 55)

Under the proposed tax law amendment, the current corporate income tax rate, which consists of four brackets (10 percent for KRW 200 million or less, 20 percent for up to KRW 20 billion, 22 percent for up to KRW 300 billion, and 25 percent for more than KRW 300 billion), will be simplified to two brackets (20 percent for KRW 20 billion or less and 22 percent for more than KRW 20 billion). Furthermore, qualified small and medium-sized enterprises (except for those carrying on consumption-oriented businesses) with the tax base bracket of KRW 500 million or less would be eligible for a 10% special tax rate with the exception of the following cases: (i) if the controlling shareholder owns more than 50% of the total shares of the company, and (ii) if the company's main business is a real estate rental business, or real estate rental income, interest and/or dividend income account for 50% or more of the company's sales revenue. The proposed tax rate will apply to business years commencing on or after January 1, 2023.

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The reduced tax rate is expected to lower the corporate income tax burden for a significant number of companies. Under the 2021 Tax Law Amendments, the effective tax rate threshold for deemed dividends under the controlled foreign company (CFC) rules was changed to "70% of the highest marginal Korean corporate income tax rate". It should be noted that under the proposed amendment, the current tax rate subject to the above CFC rules (17.5% (i.e., 70% of 25%)), will be lowered to 15.4% (i.e., 70% of 22%).

2. Tax relief for foreign taxes paid by foreign subsidiaries

(1) Participation exemption on dividends from a foreign subsidiary (Amendment of CITA §15·21·41·57·57-2, Introduction of CITA §18-4)

Under the current law, dividends received from a foreign subsidiary are included in the parent's taxable income and foreign tax credits are available for foreign corporate income tax paid on such dividends.

Under the proposed amendments, a domestic parent which has held at least 10% (5% in the case of a foreign subsidiary engaging in development of foreign energy and mineral resources) of the shares of a foreign subsidiary for at least 6 months will be entitled to exclude 95% of dividends paid by such foreign subsidiary from taxable income. The same is applicable to dividends paid by means of a reduction in the foreign subsidiary's capital reserves regardless of the percentage of shares held.

Also, where the parent-subsidiary structure results from the acquisition of a pre-existing foreign corporation (subsidiary) by a Korean corporation (parent), and where the subsidiary pays out dividends to the parent from its earnings retained prior to the acquisition, the acquisition costs of the shares in such subsidiary are reduced by such dividends.

Meanwhile, the deemed dividends under the CFC rules, dividends from hybrid financial instruments and indirect investment companies (excluding certain on-shore private equity funds) are not eligible for the above-mentioned exclusion and are instead subject to the current foreign tax credit rules. The proposed amendment will apply to dividends received on and after January 1, 2023. The dividends received through December 31, 2022 are subject to the current foreign tax credit rules.

This amendment may lead to an increase in earnings repatriated to Korea and make Korea more competitive as a regional hub.

(2) Relaxation of requirements regarding foreign subsidiaries for indirect foreign tax credit (Amendment of CITA §57⑤, CITA PD §94⑨)

Under the current law, a domestic corporation is eligible for indirect foreign tax credit where it has held at least 25% (5% in the case of a foreign subsidiary engaging in development foreign energy and mineral resources) of shares in a foreign subsidiary for at least 6 months as of the date on which the dividend amount determined. Under the proposed amendment, the ownership requirements will be relaxed to "at least 10% (5% in the case of a foreign subsidiary engaging in development of foreign energy and mineral resources)". The holding period requirement will be amended from "as of the date on which payment of dividend is determined" to "as of the date of record".

This amendment aligns the foreign subsidiary requirement for indirect foreign tax credits with the relevant requirement for the participation exemption in 2.(1), and will apply to dividends received on and after January 1, 2023.

Where the ownership requirement for an indirect foreign tax credit under a tax treaty is higher than 10%, (Canada, Denmark, Croatia (requiring at least 25%), Nepal, Saudi Arabia, Iceland, Albania, Oman, Israel, Japan (requiring at least 20%), taking into account the position adopted in existing tax rulings, it is expected that the tax authorities will permit an indirect foreign tax credit in accordance with the proposed provisions in the CITA.

3. Increased deduction for losses carried forward (Amendment of CITA §13·45·464·76-13·91)

Under the current law, qualified small and medium-sized enterprises are eligible to utilize net operating loss carryforwards to the extent of 100% of the company's income for the relevant year, while other companies have a cap on net operating loss utilization equal to 60% of the company's income for the relevant fiscal year.

Under the proposed amendment, the cap for utilization of net operating loss carryforwards by companies other than qualified small and medium-sized enterprises will increase to 80%, to be applied to fiscal years commencing on or after January 1, 2023.

This amendment is designed to improve fairness, since current loss carryforward limitations are restrictive compared to other major OECD countries.

4. Increased Incentives for Attracting Qualified Expatriates to Korea

(1) Abolishment of time limitation for flat rate (Amendment of the Special Tax Treatment Control Act ("STTCA") §18-2)

Under the current law, expatriates are eligible for a flat tax rate of 19% on salary income earned in Korea during the first five years of employment in Korea. The proposed amendment, however, will abolish the existing five-year limitation period and apply a concessional flat tax rate to expatriates even after the first five years of employment.

The amendment will apply to salary income generated on or after January 1, 2023, and the flat tax rate will again apply to expatriates whose existing tax benefits have expired.

The abolishment of time limitation is expected to promote foreign investment and employment of expatriates by Korean companies.

(2) Extension of time period for reduction of personal income tax for foreign technicians (Amendment of the STTCA §18)

Under the current law, qualified foreign engineers or researchers who meet prescribed criteria are entitled to a 50% reduction in income tax on their salary income for five years. The proposed amendment will extend the 50% reduction period from five years to ten years. The special tax treatment (i.e., 70% reduction for the first three years and 50% reduction for the next two years) for qualified engineers working in companies specialized in developing or producing specified materials and parts will expire as scheduled at the end of December 31, 2022.

The proposed amendment will apply to the first employment service provided in Korea on or after January 1, 2023, and the current (5 year) exemption period will be extended to 10 years as well.

The amendment is expected to further facilitate technology development of Korean companies by utilizing qualified foreign personnel.

5. Exemption on interest and capital gains derived from government bonds by non-residents and foreign corporations (Introduction of Personal Income Tax Act ("PITA") §119-3, Introduction of CITA §93-3)

A new exemption provision for interest and capital gains derived by non-residents and foreign corporations from government bonds and monetary stabilization bonds is proposed. Under this new exemption rule, non-residents and foreign corporations with no permanent establishment ("PE") or with no income attributable to a PE will be exempt from corporate and personal income tax on interest and capital gains derived by investing in government bonds and monetary stabilization bonds, both directly and indirectly through qualified foreign financial institutions.

The new exemption rule will apply to interest payments or sales occurring on or after January 1, 2023 and will also apply to interest derived from pre-issued government bonds and monetary stabilization bonds.

This amendment expands the scope of the exemption from qualified bonds denominated in foreign currency under Article 21 of the STTCA to KRW bonds, such as government bonds and monetary stabilization bonds. The government hopes that this will lead to increased foreign investment in Korean government bonds, leading to stabilization of the foreign exchange market and a reduction in interest rates and exchanges rates.

6. Information collection provisions (Introduction of Customs Act §254②·③)

Despite the recent surge of direct import transactions through open markets and other platform business providers, the current tax law does not provide any statutory basis for collection of information on import transactions from platform businesses by the customs authorities. The new proposed provision makes it possible for the commissioner of the Korea Customs Service or the heads of the customs offices to request information on the recipient, the traded goods, payment processing, etc. from online mall operators and other e-commerce brokers where necessary for efficient customs clearance, collection of duties and effective inspection and regulation.

This amendment will apply to import declarations filed on or after July 1, 2023, and going forward, platform businesses operating online malls and the like may receive requests for data submission from the customs authorities.

7. Implementation of global minimum tax (Introduction of Law for Coordination of International Tax Affairs (“LCITA”) §60 etc.)

(1) Scope of application

The global minimum tax will apply to multinational enterprises (groups with corporate establishments or permanent establishments in multiple countries) with revenue above EUR 750 million during at least 2 fiscal years out of the immediately preceding 4 fiscal years.

(2) Mechanism for calculating effective tax rate and top-up tax

The effective tax rate is calculated by dividing the sum of constituent entities' (enterprises belonging to the multinational enterprise group) adjusted covered taxes per jurisdiction by the sum of net global anti-base erosion ("GloBE") income.

> * Effective tax rate = (sum of adjusted covered taxes) ÷ (net GloBE income)

- The adjusted covered taxes are calculated by making certain adjustments (e.g. deferred corporate income taxes, etc.) to corporate income tax expense reflected in the accounting net profits.
- The net GloBE income is calculated by making adjustments of net tax expenses, dividends, certain valuation/disposal gains and losses, certain non-deductible expenses, prior year errors, changes in accounting policies, etc. to the accounting net profits reflected in the consolidated financial statements.

Where the effective tax rate is less than the minimum tax rate (15%) (low-tax jurisdiction), the top-up tax is calculated by multiplying the difference in tax rates to the net GloBE income.

> * Top-up tax = (minimum tax rate (15%) - effective tax rate) × net GloBE income

※ A (5%) portion of eligible "payroll" and eligible "tangible asset net book value" can be excluded from the net GloBE income.

(3) Application of Income Inclusion Rule (IIR)

The ultimate parent entity bears a primary liability for the portion of the low-taxed constituent entities' top-up tax, which corresponds to the income inclusion ratio.

Where the Income Inclusion Rule is not applied to the ultimate parent entity, a "top-down" approach is used, whereby the intermediate parent entity bears the top-up tax. Also, if an intermediate parent entity that is owned (>20% ownership) by a third party rather than a multinational enterprise group ("partially-owned intermediate entity") owns low-taxed constituent entities, then such partially-owned intermediate entity, as opposed to the ultimate parent entity, bears the top-up tax for the low-taxed constituent entities it owns.

(4) Application of the Undertaxed Payments Rule (UTPR)

Where the ultimate parent entity is low-taxed, or the residence jurisdiction of the parent entity does not implement the Income Inclusion Rule, constituent entities established in jurisdictions which have implemented the minimum global tax shall bear the top-up tax. The Undertaxed Payments Rule allocates the top-up tax in accordance with the arithmetic mean of the proportion of the number of employees and total net book value of tangible assets per jurisdiction.

(5) Filing and payment

Domestic constituent entities are required to submit GloBE Information Returns no later than 15 months after the last day of the fiscal year. As provisional relief, this period is extended to 18 months for the first fiscal year in which the global minimum tax is implemented. Where the information returns have been filed by foreign constituent entities to foreign tax authorities, domestic constituent entities are exempted from the obligation to do the same. A tax return for the allocable share of the top-up tax must be filed by the same deadline as for submission of the GloBE Information Return. Where the amount to be paid exceeds KRW 20 million, installment payments are permissible (for one month), as is the case for corporate income tax.

(6) Effective date, significance and preparations by enterprises

The OECD/G20 Inclusive Framework on BEPS originally intended Pillar Two to enter into effect by 2023. However, the GILTI amendment bill covering the minimum tax rates, is pending in the US, while legislation efforts in the EU were suspended due to a veto from Hungary. The UK tax authorities also decided to postpone initial implementation of the minimum tax from fiscal years commencing on or after April 1, 2023 to those commencing on or after December 31, 2023. Considering these global trends, as well as the need to make adjustments appropriate to the domestic market, the Korean government has decided to implement the rules on global minimum tax starting from January 1, 2024.

With a measure in place to prevent countries from “racing to the bottom” in a competition for attractive corporate income tax rates, it is expected that the tax burden of multinational enterprises is likely to increase. It is further expected that efforts to attract foreign investors will take the form of incentives, such as subsidies or reduction of indirect taxes, and that the focus will shift from competitive tax rates and deductions to adjustments in the tax base, such as tax deferrals. It will be necessary for corporations to review in advance whether tax incentives received in various jurisdictions will be included in the adjusted covered taxes, and to further review available options, such as requesting changes in investment incentives through negotiations with tax authorities.

The calculation of the global minimum tax will greatly vary depending on whether it is an ultimate parent entity, a partially-owned intermediate parent company, minority-owned constituent entities, etc. (which depends on the ownership structure). Accordingly, it will be necessary for enterprises to prepare for and minimize future tax risks by identifying affiliates subject to the minimum tax. It is also important to put in place effective accounting and tax systems and other internal processes to prepare in advance for the implementation of the global minimum tax system. It will also be necessary to closely monitor the relevant legislative developments in each jurisdiction.

8. Issuance of revised import VAT invoices (Amendment of VAT Act §35②)

Under the current VAT Act, it is very difficult to issue amended import VAT invoices when the head of the customs office has adjusted the declared customs value or where the importer has voluntarily revised prior VAT returns in anticipation of adjustments in the customs value by the customs office. Such amendments are only possible due to minor errors or where the importer is not at fault. If these requirements were not met, amended VAT invoices cannot be issued and taxpayers are prevented from claiming credit for input VAT.

Under the proposed amendment, amended VAT invoices will be able to be issued without the above restrictions unless there are special circumstances, such as cases concerning under-reporting by unjust means, violations of the penal provisions of the Customs Act, gross negligence on the part of the importer, etc.

The proposed amendment will apply to revised declarations or notifications and rectifications on or after January 1, 2023. This amendment was previously suggested as part of the 2020 Tax Law Amendment but failed to obtain approval by the National Assembly. If the proposed amendment is passed, taxpayers will be able to obtain input VAT credits on any adjustment to the import price resulting from customs audits. This will be fairer to taxpayers and also consistent with the VAT regimes in other OECD countries.

9. Calculation method for foreign tax credit on income from indirect investment companies (Amendment of PITA §129④~⑦, CITA §57①, Introduction of PITA §57-2)

Previously, foreign tax paid by indirect investment companies on income derived by investing in foreign assets was deductible from corporate income tax payable by the indirect investment companies and refundable if it exceeded tax paid ("Refund Provision"). Under the 2021 Tax Law Amendments, the system by which indirect investment companies receive credits or refunds for foreign tax paid was to be abolished, and foreign tax paid were to be deducted from the investor's withholding tax payable or subject to the investor's foreign tax credit when the dividend or financial investment income (hereafter "fund income") is paid to the investor ("Previously Intended Amendment"). The Previously Intended Amendment was intended to apply to income derived on or after January 1, 2023.

Since fund income is paid to investors net of foreign withholding tax, the Previously Intended Amendment resulted in excess deductions if foreign taxes paid were deducted in their entirety after applying the Korean withholding tax rate to the fund income.

Under the current amendment, the relative proportion of the foreign withholding tax and the Korean withholding tax rate will be considered to adjust the amount of foreign taxes to be deducted from the Korean withholding tax, thereby addressing the issue of excess deductions. Further, the amount of foreign tax paid adjusted by considering the relative proportion of the foreign withholding tax rate and the Korean income tax rate will be deductible from the calculated tax in the case of filing a tax return (which is filed by individual investors with regard to their income from financial investments and corporate investors with regard to their corporate income). Where the tax rate adjustment results in an excess foreign tax credit limitation, such amount can be carried forward for 10 years.

Under the current amendment, the Refund Provision will continue to apply until January 1, 2025, with the amended provisions applying to income derived on or after January 1, 2025. The Previously Intended Amendment will not come into effect. This proposed amendment is meaningful because it resolves the issue of excessive deductions for foreign taxes paid and further improves the formula for calculating foreign tax credits when investing through indirect investment companies by allowing carry forwards of foreign taxes paid over a period of 10 years.

10. General National Tax Matters

(1) Extension of requirement for maintaining books and records for offshore transactions (Amendment of National Tax Basic Tax (“NTBA”) §85-3②)

Under the current law, taxpayers are required to keep and retain books and records related to transactions for 5 years after the expiry of the statutory due date for tax return filings. It has been proposed that the retention period be extended to 7 years for offshore transactions, given that the statute of limitations for international transactions is 7 years.

The proposed amendment will apply to books and records being retained on or after January 1, 2023.

(2) New requirement for retention of transfer pricing related documents at domestic place of business (Introduction of NTBA §85-3①)

The NTBA currently requires taxpayers to retain books and evidentiary documents relating to all transactions pursuant to the provisions of the applicable tax laws.

Under the proposed amendment, taxpayers are required to retain transfer pricing related documents, which include an organizational chart, roles and responsibilities, agreements involving asset sales and purchases and the like, at a place of business in Korea, such as the address registered with the local tax office.

The proposed amendment will apply to transactions taking place on or after January 1, 2023. Once the amendment comes into effect, multinationals that maintain and manage Korean transfer pricing related documents outside Korea are required to ensure their Korean subsidiaries are in compliance with the new requirement.

11. Abolishment of retained earnings tax (Amendment of STTCA §100-32)

Under the current law, conglomerates, mid-sized enterprises and domestic subsidiaries of multinational enterprises with equity capital exceeding KRW 50 billion are required to pay corporate income surtax on certain retained earnings. This surtax tax is calculated by taking a certain percentage of corporate income (70% or 15%) and applying 20% to retained earnings that were not used for qualified investments, salary increases, and certain designated expenditures to foster collaboration.

The system of granting tax incentives for promoting investment and collaboration has been criticized as being disproportionately excessive in burdening corporations without being effective in achieving their original goals. Recently, the Korean Chamber of Commerce asked the Korean government and the National Assembly to consider abolishing the system, citing the tax burden on corporations. Considering that the support for investment and collaboration can be encouraged through comprehensive investment tax deductions, tax deductions for increased salaries, tax deductions for collaborative cooperation contributions, etc., this retained earnings tax is proposed to be abolished.

It is expected that the corporate income tax burden will be reduced for conglomerates, mid-sized enterprises and domestic subsidiaries of multinational enterprises with equity capital exceeding KRW 50 billion from 2023.

12. Strengthened documentation requirements for treaty exemption application (Amendment of PITA §156-2·6, CITA §98-4·6, PITA PD §207-2·8, CITA PD §138-7)

Under the current law, where non-residents and foreign corporations intend to claim a treaty exemption, they are required to submit their residency certificates to the withholding agent, who is required to submit the documents to the relevant tax office.

Under the proposed amendment, documents evidencing the establishment of the foreign corporation and its operations, and documents showing the amount of the Korean-source income have been added in the list of the documents required to be submitted. Further, where it is difficult to assess the eligibility for tax treaty exemptions based on the submitted documents, the relevant tax office may request additional documents from the applicants (i.e., non-residents and foreign corporations) and can issue notifications or rectifications where the tax office feels the taxpayer is ineligible or where the contents of the application are believed to be false. The withholding agent can also request that non-residents and foreign corporations submit the required documents.

The proposed amendment will apply to treaty exemption applications filed on or after January 1, 2023. The broadened obligation to submit materials relating to eligibility for exemption is expected to more aggressively challenge withholding exemptions, further burdening taxpayers. We also note that the amendment does not provide for advance tax clearance upon review of the applicable documents by the tax office, so future tax auditors will also be able to challenge the application of treaty exemption.

13. New information submission requirements for liaison offices (Introduction of CITA § 94-2②·③)

The 2021 Tax Law Amendment introduced a new provision that requires liaison offices of foreign corporations to submit basic information (personal details of representatives), information on foreign headquarters and other subsidiaries in Korea, and data on Korean transaction parties. The submission due date is February 10th of the following year. This provision applies to fiscal years commencing on or after January 1, 2022.

Under the proposed amendment, liaison offices are required to submit summary statements of receipts for each transaction party in addition to the above data (by February 10th). The proposed amendment applies to transactions (receipt of goods or services) taking place on or after January 1, 2023.

It is expected that the summary statements will be used to determine whether liaison offices constitute PEs and to determine the VAT and corporate income tax impact of any potential PEs.

14. Exemption from submission of international transaction details (Amendment of LCITA §16②, LCITA PD §36)

Under the current law, a taxpayer engaging in transactions with a foreign related party is required to submit data on such international transactions. Where certain requirements are met, certain data can be exempted from the scope of submission. Under the amendment, the scope of such amendments will be broadened for some data, while for others, stricter requirements will apply, as provided in the following table.

[Exemption requirements for submission of international transaction related information]

Data	Prior to Amendment	Following Amendment
Statement of International Transactions	Exempted if a taxpayer submits a Local File or Master File	Exempted if a taxpayer submits a Local File or Master File, or if the total amount of the transactions with the foreign related party does not exceed the following values: KRW 500 million for transactions of goods; KRW 100 million for transactions of services, KRW 100 million for transactions of intangibles
Summarized Profit & Loss Statement for Foreign Related Parties	Exempted if the total amount of the transactions with the foreign related party does not exceed KRW 1 billion for transactions of goods, and KRW 200 million for transactions of services	Exempted if the total amount of the transactions with the foreign related party does not exceed KRW 1 billion for transactions of goods, KRW 200 million for transactions of services, and KRW 200 million for transactions of intangibles
Statement of Transfer Pricing Method	Exempted if i. the total amount of the transactions involving goods does not exceed KRW 5 billion, and the total amount of the transactions involving services does not exceed KRW 1 billion; or; ii. the total amount of the transactions involving goods with each foreign related party does not exceed KRW 1 billion and the total amount of the transactions involving services for each foreign related party does not exceed KRW 200 million	Exempted if i. the total amount of the transactions involving goods does not exceed KRW 5 billion, the total amount of the transactions involving services does not exceed KRW 1 billion, and the total amount of the transactions involving intangibles does not exceed KRW 1 billion; or; ii. the total amount of the transactions involving goods with each foreign related party does not exceed KRW 1 billion, the total amount of the transactions involving services with each foreign related party does not exceed KRW 200 million, and the total amount of the transactions involving intangibles with each foreign related party does not exceed KRW 200 million

The amendment applies to fiscal years commencing on or after January 1, 2023. The scope of the exemption for the Statement of International Transactions has been extended, while the amendment is expected to result in a larger burden for taxpayers engaging in transactions involving intangibles with foreign related parties.

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