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Korean Tax Brief

Update on Current Issues and Trends

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1. 2018 Korea Tax Revisions

2018 Korea Tax Revisions pass the National Assembly plenary session

The 2017 Tax Revision Bill passed the National Assembly plenary session on December 5, 2017. In the main revised tax law, the maximum tariff on corporation income tax is newly enacted, the capital gains tax rate for major shareholders is increased, and furthermore, the requirements on qualified merger and division are strengthened, which requires succession of employment in addition to current conditions. In addition, limitation on losses carried forward deduction is partially changed, and the amount of interest expenses deductible can be adjusted in case interest expenses paid to foreign affiliates are excessive. The details are as follows.

(1) The revised tax law established a new maximum tariff of 25% on corporation income tax. According to the revised tax law, tax rate of 10% is applied to the tax base of KRW 0~200 million, 20% for the tax base of KRW 200 million~20 billion, 22% for the tax base of KRW 20 billion~300 billion, and finally 25% for the tax base exceeding KRW 300 billion.

(2) The capital gains tax rate for major shareholders is also increased. For the tax base of KRW 300 million or less, tax rate of 20% is applied as before, but increased rate of 25% is applied for the tax base that exceeds KRW 300 million. The revised rates are applied for stock transfers that are occurred from January 1, 2018. For major shareholders of SMEs, however, grace period is given, and the revised rates will be applied for stock transfers that are occurred after January 1, 2019.

(3) In order to prevent companies from using mergers and divisions for downsizing workforce purposes, succession of employment condition is added to the existing requirements for qualified merger and division. As a result, the same requirement (i.e. succession of employment) is also added to the requirements of deferred taxation of capital gains occurring due to merger and division. The surviving company should maintain the number of employees to at least 80% of the sum of employees of the surviving firm and the merged company as of one month prior to the registration date of the merger. If not, it may be disqualified for deferred taxation of capital gains, and be charged for previously deferred corporate income tax.

(4) Bounds of losses carried forward deduction are changed. Previously companies could deduct losses carried forward from their income up to 80% of the current fiscal year income, but the deductible ratio is decreased to 70% for income occurring in 2018, and even more decreased rate of 60% is applied for income occurring from 2019 and thereafter. In case of SMEs, however, there are no changes for the deductible ratio, which is 100% of the current year income. The deductible ratio of 70% is applied from the fiscal year commencing on or after January 1, 2018, and 60% is applied from the fiscal year commencing on or after January 1, 2019.

(5) Lastly, in order to prevent tax avoidance of multinational corporations through excessive deduction of interest expenses, limitation on deductible interest expenses are applied for domestic corporations that pays interest to foreign related parties. Interest expenses that exceeds a certain percentage (30%) of net interest expenses divided by tax-adjusted income is not deductible. This regulation will be effective from the fiscal year commencing on or after January 1, 2019

Introducing Promotion on Investment and Collaborative Cooperation Tax

As the sunset date for the Tax Regime for Corporate Earning Recirculation (applicable for FY2015~ FY2017) is December 31, 2017, 2018 Korea Tax Revisions introduces a new Tax Regime for Promotion on Investment and Collaborative Cooperation Tax.

In Corporate Earning Recirculation Tax Regime, a certain portion of investment amount, increased salary amount, dividend amount were considered to reduce Corporate Earning Recirculation Tax. In comparison, the new Tax Regime, Promotion on Investment and Collaborative Cooperation Tax, does not consider the dividend amount. Companies with net asset value exceeding KRW 50 billion as well as large conglomerates are subject to the newly legislated Promotion on Investment and Collaborative Cooperation Tax.

However, in case the taxable income exceeds KRW 300 billion, the exceeding amount is not subject to Promotion on Investment and Collaborative Cooperation tax. This is because the tax burden will be excessive that if such taxes are added to CIT, an increased CIT rate of 25%, which is 3% higher than previous CIT rate, is applied to taxable income that exceeds KRW 300 billion.

2. Recent Supreme Court and Tax Tribunal Cases

In order to deny the form of transactions and to impose taxes on the substantial transaction, the series of transactions must be meaningless individually, having only tax avoiding purposes (the Supreme Court 2017Du57516, 2017.12.22)

Article 14 (3) of The Basic Law for National Taxes (“BLNT”) specifies that “In case the taxpayer is recognized to be intended to unfairly benefit from tax laws by using indirect transactions through a third party or by using two or more transactions, the tax laws are applied in terms of the substance over form, by deeming the substantial parties to have participated in the transactions or deeming the sequence of transactions as a single transaction”.

The purpose of the Article 14 (3) of BLNT is to apply the substance over form rule, and furthermore to promote the fairness of taxation. In order to cope with unfair tax avoidance activities using multiple stages of transformed transactions to avoid being treated as a taxable transaction, the law enables it possible to deny the form of transactions and impose taxes on the substantial transaction.

However, taxpayers can select freely among possible legal transactions in order to achieve same economic purpose, and unless there exists a plausible reason, the tax authorities may respect the regarding taxpayer’s choice (refer to the Supreme Court 2001.8.21. Sentenced 2000Du963).

In addition, it is unfair to jump into conclusion by only judging with the result of the sequence of transactions. The result of such transactions can include reward for risk-taking of possible losses or external factors and actions, and in this sense, it is a hasty conclusion to impose taxes on such transactions by deeming them as a substantially single transaction.

Specifically, the Supreme Court quoted the ruling of the lower court that in order to deem a series of activities of capital increase, borrowing and repayment of debt as a single debt-equity conversion activity, it is difficult to regard the series of activities are individually meaningful as intermediate transactions for only tax avoiding, and moreover, the activities as a whole should substantially correspond to debt-equity conversion.

Imposing VAT on the basis of the information derived from the tax audit results of the counterparty (Josim2017Seo3970, 2017.11.03.)

The tax office acquired the actual transaction amount, transaction details and input tax invoices during a tax audit on the counterparty. In addition, the CEO of the counterparty admitted that the payment had been settled by cash, and that his company had not received any relevant tax invoice. Furthermore, the company claiming unfairness on the VAT imposed by the tax office did not present any objective and concrete evidence in order to identify whether the amount of tax imposed from the previous tax audit overlaps with the controversial amount of omitted sales. In this regard, it is reasonable for the tax office to impose VAT based on the information derived from the tax audit results of the counterparty.

Withholding tax penalty cannot be imposed even if the beneficial owner turned out to be different, in case the withholding agent did not know the existence of the beneficial owner (Josim 2016Jeon3940, 2017.12.20)

The transferor of the stocks and the transferee company who is the withholding agent of such transaction, deemed that the capital gains from the sale of such stocks were tax exempt, according to the tax treaty. In this regard, the transferor submitted ‘application of tax exemption on Corporate Income Tax on capital gains’ through the withholding agent, and accordingly the withholding agent did not withhold any taxes on the capital gains.

Penalty taxes can be seen as an administrative sanction that is imposed when the taxpayer does not fulfil the duties of faithful tax base reporting and payment of relevant tax amount, for the purpose of optimal taxation. In this light, in case the taxpayer has justifiable reasons or when it is unreasonable to expect the taxpayer to fulfil his duties, failure to report tax base and to pay taxes can be justified, even if the imposition of principle tax is legitimate.

The Tax Tribunal, for its specific reasons, stated that (i) in practice, it is difficult to demand the withholding agent to discriminate the beneficial owner of the capital gains and withhold such taxes, and thus it is only possible to see the nominal owner of the capital gains as the substantial beneficial owner; (ii) it is unreasonable to expect the withholding agent to be able to perfectly judge in a situation that even the tax authorities cannot easily decide whether such capital gains from stocks are taxable income; (iii) the withholding agent performed all necessary procedures as a domestic tax withholding agent by submitting a tax exemption application to the tax authorities and receiving a receipt. In this regard, the withholding agent has sufficient reasons for failing to meet its withholding duties, and therefore, there is no sufficient reason to impose withholding tax penalty on such case.

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