

# Korean Tax Brief

## Update on Current Issues and Trends



### 1. Tax News

#### (1) National Tax Service announces an administrative notice on the proposed amendment of the corporate income tax administrative procedural guidelines

On April 19, 2019, the National Tax Service (hereinafter “NTS”) announced an administrative notice proposing to amend the corporate income tax administrative procedural guidelines. Key aspects of the proposed amendment are as follows; (i) requiring issuance of an extension notice to taxpayers when the period for processing tax information and reviewing taxpayer reported compliance materials by the NTS is extended, (ii) creating a new introductory material, “Guidance on the Taxpayer Rights Protection Request System” to be provided to taxpayers upon NTS’ request for taxpayer’s supporting documents and (iii) revising and adding provisions for non-profit corporations in the Inheritance Tax and Gift Tax Law.

#### (2) The Ministry of Economy and Finance announces an extension of the temporary fuel tax cut

On April 12, 2019, the Ministry of Economy and Finance announced a plan to extend the temporary tax break for fuel products which became effective on November 6 last year. Initially, the temporary tax cut was scheduled to end on May 6, 2019 but has been extended by 4 months until August 31, 2019. However, the extent of rate reduction will be decreased from 15% to 7%. During the extended 4-month period, it is expected that the fuel price will be reduced by 58 KRW/ℓ for gasoline, 41 KRW/ℓ for diesel and 14 KRW/ℓ for LPG butane. The overall amount of tax savings due to the extended tax cut is anticipated to be approximately KRW 6 trillion during the 4-month period.

#### (3) NTS initiates tax audits targeting new high-income earners such as YouTubers, celebrities and foreign athletes

NTS announced on April 10, 2019 that it will undertake tax audits targeting popular YouTubers who earn high income by benefiting from the development of IT technology and

diversified global businesses, celebrities and foreign athletes. NTS has selected 176 individuals, including YouTubers, athletes, licensed professionals and real estate business owners who have earned substantial income from new and booming markets but are suspected to have evaded tax through aggressive tax planning techniques and launched a simultaneous tax audit on those individuals.

NTS suspects that as the number of high-income earners in the new markets have increased, tax evasion techniques have advanced. Therefore, the NTS collected tax and financial information from various organizations such as the Bank of Korea, the Korea Customs Service and the National Health Insurance Service and prioritized the suspicious tax evaders who are now subject to tax audit. In the course of the tax audits, if intentional tax evasion through methods such as using a borrowed-name bank account, keeping two sets of books or receiving fictitious tax invoices are discovered, NTS is planning to convert the tax audit into a tax criminal investigation and impose sanctions through prosecution, etc.

#### (4) NTS announces an administrative notice on the proposed amendment of the tax audit administrative procedural guidelines

On April 4, 2019, the NTS announced an administrative notice proposing to amend the tax audit administrative procedural guidelines. The following are key aspects of the proposed amendments.

- Refine the definition of a “tax audit” in the administrative procedural guidelines to exclude tax criminal investigations through amendment to the Basic National Tax Law.
- Add tax refund requests made by foreign individuals or corporations with respect to reduced withholding tax rates and tax exemptions granted under the tax treaty within the scope of cases for which a partial tax audit can be conducted.
- Clarify that if a taxpayer is subject to multiple types of tax audits simultaneously, a simultaneous tax audit will be conducted by aligning the audit periods of the multiple tax audits.

- Establish a Transfer Pricing Review Committee.
- Notify the taxpayer in advance if the taxpayer is selected for a tax criminal investigation.

### **(5) NTS holds the first National Tax Administration Reform Committee meeting in 2019**

The National Tax Administration Reform Committee held its first meeting on March 13, 2019 at the Seoul Regional Tax Office to discuss and advise on major projects and main issues for the current year. In the meeting, it was discussed that the work burden of tax auditors will be relieved by increasing the portion of regular tax audits while gradually reducing the total number of tax audits during the year. In addition, tax auditor's compliance with tax audit procedures will be strengthened through planned reform of the internal evaluation system. In addition, the NTS will deal strictly with gift and inheritance tax and off-shore tax evasions achieved through illegal and unjust methods. To promote job creation and stimulate economic growth the NTS will expand its tax support to certain small and medium size enterprises ("SMEs") by postponing tax audits, exempting from tax collateral requirements and deferring tax collection.

### **(6) Korea is removed from EU tax-haven blacklist**

On March 12, 2019, the EU Economic and Financial Affairs Council (hereinafter "ECOFIN") decided to delete Korea from its list of non-cooperation tax jurisdictions. The Korean government created a task force team in 2018 to review the effectiveness of the existing tax benefits provided to foreign investors and decided to abolish those tax benefits. Instead, it shifted the focus of such benefits to support new growth industries, investment and job creation. As the Korean government informed ECOFIN of the aforementioned reform of the existing tax benefit system targeting foreign investors, ECOFIN deleted Korea from its tax haven blacklist.

## **2. Recent Regulations and Precedents**

### **(1) Mold is regarded as a qualified asset eligible for the Job Creation Investment Tax Credit (The Ministry of Economy and Finance, Division of Special Taxation -305, 2019. 4. 17)**

The tax ruling clarified that mold (except for those that are immediately tax-deductible as expense) is not included in the list of business assets that are specifically excluded as assets not eligible for the Job Creation Investment Tax Credit.

### **(2) Whether the grace period for SME is applicable (Sajeon-2019-Interpretation of Corporate Income Tax Law -0014 2019.03.28)**

The tax ruling indicated that although a subsidiary no longer satisfies the independence condition which is assessed based on the parent company's ownership threshold (i.e.,

ownership exceeds a certain percentage) in the subsidiary due to a merger between subsidiaries, the subsidiary can maintain its SME status and qualify for tax credits SMEs are eligible to claim during the prescribed grace period.

### **(3) Income classification of interest income which is treated as deemed dividend for Korean tax purposes due to its non-deductibility for exceeding the market value or the thin-cap ratio and the applicable withholding tax rate (The Ministry of Economy and Finance, Division of Tax Policy -523, 2019. 3. 21.)**

Interest income treated as dividend pursuant to Article 9 and Article 14 of the Adjustment of International Taxes Law should be classified as interest in accordance with Article 13, Paragraph 6 of the Korea-U.S. Tax Treaty and the respective tax shall be withheld according to the Korean Tax Law.

### **(4) Whether penalties paid to the U.S. Department of Justice according to the decision from the U.S. Court are regarded as domestic source income (The Ministry of Economy and Finance, Division of International Tax-114, 2019. 3. 20.)**

If penalties imposed for violation of relevant laws of the U.S. due to price collusion with other corporations in Korea are paid to the U.S. Department of Justice in accordance with the U.S. court decision and are regarded as compensation for punitive damages, such penalties shall be treated as domestic source income classified as other income. However, such penalties should not be taxable in Korea if they are not considered unrelated business income of a non-profit foreign corporation.

### **(5) Surviving corporation's net operating loss carryover transferred from target corporation can be deducted up to 60% of the taxable income of the target corporation each business year (Seomyeon-2018- Interpretation of Corporate Income Tax Law -2313, 2019. 2. 28.)**

In case a surviving corporation is subject to a qualified merger pursuant to the Article 44-3-(2) of the Corporate Income Tax Law ("CITL"), and the corporation merged into the surviving corporation ("target corporation") is neither a SME pursuant to the Restriction of Special Taxation Law Article 5-1 nor is in the midst of a workout plan due to insolvency pursuant to the Decree of the CITL Article 10-1, the net operating loss carryover transferred from the target corporation to the surviving corporation can be deducted up to 60% of target corporation's taxable income (70% is applied for the business year from January 1, 2018 to December 31, 2018).

### **(6) The calculation method of the acquisition price of a domestic corporation's shares for purposes of computing deemed dividend income to be recognized as a result of a capital reduction of the domestic corporation by its**

**parent company which is a new corporation established as part of a spin-off (The Ministry of Economy and Finance, Division of International Tax -77, 2019. 2. 25)**

After a Dutch corporation spun off its shareholding in a domestic corporation at book value to a newly established Dutch corporation (with no place of business in Korea), the domestic corporation reduced its capital. For purposes of computing the deemed dividend to be recognized by the parent corporation (i.e., the newly established Dutch corporation) upon the capital reduction, the parent corporation's acquisition price of the domestic corporation's shares should be the book value of those shares at which they were spun-off to the parent corporation.

**(7) Whether interest on advance payment received by foreign ship owners based on a shipbuilding contract should be treated as domestic source other income under the CITL (The Supreme Court 2017du48482 2019.04.23.)**

Upon cancellation of a shipbuilding contract entered into among domestic shipbuilders and foreign ship owners, the guarantor (plaintiff) of the contract returned to the foreign ship owners the advance payment made to the domestic shipbuilders and paid the respective interest accrued on the advance payment. Since it is reasonable to view that the interest paid on the advance payment was to restore the foreign ship owners' actual losses in their net asset position instead of compensating the foreign ship owners for any punitive damages, the Supreme Court annulled the original decision of the lower court which ruled that the nature of the interest payment is compensation for punitive damages which is classified as other income.

**(8) If a professional soccer player earns income overseas as a player in the Japanese soccer league and stays in Japan for most of the time during the tax period at issue without performing any social or business activities in Korea, the soccer player's "center of vital interests" under the Korea-Japan Tax Treaty should be Japan (The Supreme Court 2018du60847 2019. 3. 14.)**

The plaintiff, a professional soccer player, was considered a dual tax resident in Korea and Japan and thus had to determine his ultimate tax residency based on the "permanent residency" and the "center of vital interests" standards under the Korea-Japan Tax Treaty. While the soccer player maintained permanent residences in both Korea and Japan, the soccer player stayed in Japan for most of the time during the tax period at issue without performing any social or business activities in Korea other than staying in Korea temporarily to participate as a national soccer player. Considering the soccer player's personal and economic relationships on a comprehensive basis, the court ruled that the soccer player's center of vital interests should be Japan and thus regarded him as a tax resident of Japan in accordance with the Korea-Japan Tax Treaty.

**(9) Whether the corporation can apply the interest rate of a domestic Korean Won ordinary savings account as the arm's length interest rate to loans made to foreign related parties (Tax Tribunal 2018jeon2263, 2019. 3. 12.)**

Although the Korean tax authority applied an interest rate of domestic Korean Won ordinary savings account as the arm's length interest rate to loans made to foreign related parties, such approach was not accepted by the Tax Tribunal. Specifically, the Tax Tribunal noted that i) an interest rate is generally determined by adding an additional interest rate which depends on the borrower's credit status to the base interest rate, and ii) the additional interest rate should be determined by considering various factors such as the borrower's creditworthiness and the applicable interest rate based on local standards. Considering that the interest rate of domestic Korean Won ordinary savings account does not account for the aforementioned factors, the Tax Tribunal indicated that such interest rate could not be regarded as an arm's length interest rate. In addition, the Tax Tribunal noted that since the taxpayer applied LIBOR as the base rate and added the same additional interest rate to all long-term loan transactions with its foreign affiliates, the LIBOR plus a specified additional interest rate could be regarded as an arm's length interest rate. However, since it is unclear whether the additional interest rate applied to all related party loans equally was determined by taking into account the various factors listed under Article 6(7) of the Adjustment of International Taxes Law, the Tax Tribunal decided that the reasonableness of the additional interest rate should be re-examined.

**(10) In case a taxpayer acquires an asset at a price lower than the market price from a related party (i.e., an unjust transaction), whether the actual purchase price should be regarded as the tax base for acquisition tax purposes under the Article 10(5) of the Local Tax Law that was in effect at the time of the transaction (The Supreme Court 2018du60694 2019. 2. 14.)**

Although the general rule under the Local Tax Law is to treat the actual purchase price of an asset as the tax base for acquisition tax purposes, an exception to the general rule applies in case the relevant transaction is regarded as an unjust transaction as described under the Korean tax law. In other words, although a taxpayer acquires an asset at a price lower than the market price, if such transaction is regarded as an unjust transaction, the taxpayer will be subject to acquisition tax based on the market price of the asset rather than the actual cost paid. Considering that the legislative intent of the aforementioned exceptional rule is to prevent unjust avoidance of acquisition tax by reporting a tax base that is unjustifiably low, the taxpayer's acquisition which is regarded as an unjust transaction should be subject to the exceptional rule, and thus the acquisition tax base of the relevant asset should be the market price of such asset.

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