

# Korean Tax Brief

## Update on Current Issues and Trends



### Highlights of 2018 Proposed Amendments to Enforcement Decrees of Tax Laws

The Ministry of Economy and Finance has announced 21 amendments to Enforcement Decrees of tax laws in order to reflect the 21 tax law revisions passed in the National Assembly in December 2018. The amendments to the Enforcement Decrees will become effective in February after the pre-announcement of legislation ('19.1.8 ~ 19.1.29), deputies council, and cabinet council. We have summarized below the amendments that may affect foreign investors or foreign invested companies.

#### I. Enforcement Decree of the International Tax Coordination Law

##### 1. Establish Criteria for Commercial Rationality of International Transactions [Enforcement Decree of the International Tax Coordination Law §4⑤·⑥]

Current	Amendment
<Newly Enacted>	<p><b>(Objective)</b></p> <p>✓ Identify substance of international transactions and establish principles for denial or reconstruction of transactions by adopting international standards of transfer pricing taxation</p> <p><b>(Content)</b></p> <p>✓ Considerations for identifying substance of international transactions</p> <ul style="list-style-type: none"><li>- In addition to the terms of the contract, the functions* performed by the transaction party, types and characteristics of goods and services, economic conditions, and business strategies should be collectively considered (*including the assets used by the transaction party, risks born, etc.).</li></ul> <p>✓ Considerations for commercial rationality of international transactions</p> <ul style="list-style-type: none"><li>- An agreement on the terms of the transaction should not be expected among the independent companies. However, the determination should not be made solely based on the fact that similar transactions have not been found among independent companies.</li></ul> <p>✓ It should be favorable for the business not to conclude the transaction or to conclude the transaction differently.</p> <p>✓ Tax burden should be significantly reduced by the transaction.</p> <p><b>(Effective Date)</b> Effective on the date of promulgation</p>

## 2. Establish Basis for Use of Open Market Price When Applying Comparable Uncontrolled Price Method to Open Market Products [Enforcement Decree of the International Tax Coordination Law §4①]

Current	Amendment
<ul style="list-style-type: none"> <li>□ Comparable Uncontrolled Price ("CUP") Method <ul style="list-style-type: none"> <li>- (Principle) Calculate arm's length price using the transfer price between independent unrelated parties in comparable international transactions</li> <li>- &lt; Addition &gt;</li> </ul> </li> </ul>	<p><b>(Objective)</b></p> <p>✓ Specify an option to calculate an arm's length price based on an open market transaction price by adopting international standards of transfer pricing taxation</p> <p><b>(Content)</b></p> <p>✓ Considerations for calculating arm's length price of crude oil, agricultural products, mineral, and other commodities based on the CUP method</p> <ul style="list-style-type: none"> <li>- Differences in transaction conditions* between the international transaction and the open market transaction should be reasonably adjusted (*physical characteristics of goods, quality, transaction volume, transaction time, transportation, etc.).</li> <li>- A pricing date* agreed by the transaction parties will be approved if the taxpayer submits reliable supporting documents. However, if the supporting documents are not submitted or if there is any other evidence, the pricing date will be estimated based on such evidence (*base date for calculating price of goods).</li> </ul> <p><b>(Effective Date)</b> Effective on the date of promulgation</p>

## 3. Improve Safe Harbor for Arm's Length Price of Payment Guarantee [Enforcement Decree of the International Tax Coordination Law §6-2④]

Current	Amendment
<ul style="list-style-type: none"> <li>□ Types of arm's length price calculation methods for guarantee fees <ul style="list-style-type: none"> <li>① Benefit approach : Calculate based on the expected benefit of the obligor</li> <li>② Cost approach : Calculate based on the expected cost and risk of the guarantor</li> <li>③ Cost and benefit approach : Calculate based on the expected cost and risk of the guarantor and the expected benefit of the obligor</li> </ul> </li> <li>□ Safe harbor for arm's length price of guarantee fees <ul style="list-style-type: none"> <li>- Fees calculated using the benefit approach designated by the National Tax Service</li> <li>- Fees calculated using the difference in interest rates, calculated by a financial institution, resulting from the existence of payment guarantee</li> </ul> </li> </ul>	<p><b>(Objective)</b></p> <p>✓ Improve taxpayer's convenience by diversifying methods of arm's length price calculation for guarantee fees</p> <p><b>(Content)</b></p> <p>✓ Diversify calculation methods for deemed guarantee fees</p> <ul style="list-style-type: none"> <li>- Add cost approach and cost and benefit approach to the safe harbor</li> </ul> <p><b>(Effective Date)</b> Effective for a payment guarantee executed after the date of promulgation</p>

#### 4. Improve Arm's Length Price Calculation Methods for Intangible Asset Transactions

##### (1) Enhance definition of intangible asset [Enforcement Decree of the International Tax Coordination Law §6-3, §14-2①]

Current	Amendment
<ul style="list-style-type: none"> <li>□ Definition of intangible asset and scope of application           <ul style="list-style-type: none"> <li>① Patent, utility model right, design right, trademark, service mark, and copyright</li> <li>② Any other intangible property, including a design, model, and know-how, which can be used as it is or transferred or licensed to others</li> </ul> </li> </ul> <p>(Scope of application) Cost contribution agreement for joint development of intangible asset</p>	<p><b>(Objective)</b></p> <ul style="list-style-type: none"> <li>✓ Reflect international standards of transfer pricing taxation to the definition of intangible asset subject to tax adjustment due to arm's length price and scope of application</li> </ul> <p><b>(Content)</b></p> <ul style="list-style-type: none"> <li>✓ Clarify definition of intangible asset and scope of application           <ul style="list-style-type: none"> <li>- General definition of intangible asset               <ul style="list-style-type: none"> <li>① Asset that is not a physical asset or financial asset</li> <li>② Asset that is capable of being owned or controlled by a specific person for use in commercial activities</li> <li>③ Use or transfer between independent parties is generally compensated appropriately</li> </ul> </li> <li>- Items included in intangible asset               <ul style="list-style-type: none"> <li>① Patent, utility model right, design right, trademark, service mark, and copyright</li> <li>② Know-how, trade secret, customer information and network, company name, brand, goodwill, government business right, and contractual right</li> </ul> </li> <li>- Scope of application: may also be used when calculating arm's length price of intangible asset being transferred or licensed</li> </ul> </li> </ul> <p><b>(Effective Date)</b> Effective for a tax year commencing after the date of promulgation</p>

##### (2) Establish principles of arm's length price for intangible asset transactions [Enforcement Decree of the International Tax Coordination Law §6-3]

Current	Amendment
<Newly Enacted>	<p><b>(Objective)</b></p> <ul style="list-style-type: none"> <li>✓ Establish principles of compensation for functions performed, such as development, improvement, maintenance, protection, and utilization of intangible asset, and arm's length price calculation methods by adopting international standards of transfer pricing taxation</li> </ul> <p><b>(Content)</b></p> <ul style="list-style-type: none"> <li>✓ Principles for determining arm's length price calculation method</li> </ul>

Current	Amendment
<p>&lt;Newly Enacted&gt;</p>	<ul style="list-style-type: none"> <li>- Apply CUP Method, profit split method, and valuation method* first (*discount future cash flow to current value)</li> <li>■ When using valuation method, reasonable assumptions should be made for cash flow projection, growth rate, discount rate, useful life, and residual value of intangible asset</li> </ul> <p>✓ Principles for attribution of income from intangible asset</p> <ul style="list-style-type: none"> <li>- In accordance with the arm's length principle, properly compensate the company that has actually performed the functions, such as development, improvement, maintenance, protection, and utilization of intangible asset</li> <li>- A company should not receive excessive compensation compared to the functions, such as development, improvement, maintenance, protection, and utilization of intangible asset, only because it has a legal ownership of the intangible asset</li> </ul> <p>(Effective Date) Effective for a tax year commencing after the date of promulgation</p>

**(3) Establish principles of arm's length price for hard-to-value intangible Asset** *[Enforcement Decree of the International Tax Coordination Law §6-3]*

Current	Amendment
<p>&lt;Newly Enacted&gt;</p>	<p>(Objective)</p> <p>✓ In case of hard-to-value intangible asset, allow determining appropriateness of transaction price based ex post outcomes by adopting international standards of transfer pricing</p> <p>(Content)</p> <p>✓ Definition of hard-to-value intangible asset</p> <ul style="list-style-type: none"> <li>- There is no comparable transaction for the intangible asset transaction</li> <li>- There is high uncertainty for the economic benefit expected from the intangible asset</li> </ul> <p>✓ Principles of arm's length price</p> <ul style="list-style-type: none"> <li>- If an arm's length price based on ex post value significantly differs from the transaction price, the transaction price is deemed determined not based on reasonable assumptions</li> </ul>

Current	Amendment
<p>&lt;Newly Enacted&gt;</p>	<ul style="list-style-type: none"> <li>■ Calculate and adjust arm's length price based on the ex post value which reflects changing transaction situations and economic conditions</li> <li>- An arm's length price should not be calculated based on the ex post value for the following situations : <ul style="list-style-type: none"> <li>■ If the taxpayer proves that the transaction price of the intangible asset is based on reasonable assumptions</li> <li>■ If the difference between the ex post value arm's length price and the transaction price does not exceed 20% of the transaction price</li> <li>■ If the arm's length price calculation method has been pre-approved pursuant to an agreement by the relevant tax authorities</li> </ul> </li> </ul> <p>(Effective Date) Effective for a tax year commencing after the date of promulgation</p>

## II. Enforcement Decree of the Corporate Income Tax Law

### 1. Add Compromise by Court and Compromise Recommended by Court to Reasons for Bad Debt

*[Enforcement Decree of the Corporate Income Tax Law §19-2①]*

Current	Amendment
<p><input type="checkbox"/> Receivables that can be deducted as bad debt</p> <p>✓ Receivables from export of goods or provision of services in a foreign country, which are exempt from the obligation to collect by the Governor of the Bank of Korea or the President of a foreign exchange bank under the statutes relating to foreign exchange transactions</p> <p>✓ &lt;Addition&gt;</p>	<p><b>(Objective)</b></p> <p>✓ Reflect the deletion of the obligation to collect claims provision in the Foreign Exchange Transaction Law.</p> <p>✓ Reduce taxpayer's burden, considering having the same effect as final judgment</p> <p><b>(Content)</b></p> <p>✓ Receivables exempt from the obligation to collect : Deleted</p> <p>✓ Addition : Receivables that are determined to be non-recoverable due to compromise by court or compromise recommended by court</p> <p>(Effective Date) Effective for compromise by court or compromise recommended by court decided after the date of promulgation</p>

## 2. Revise Timing of Deduction for Fixed Asset Impairment Loss *[Enforcement Decree of the Corporate Income Tax Law §78]*

Current	Amendment
<p><input type="checkbox"/> Exceptional reasons for asset impairment            (Exception) Deductibility of book value impairment ;            - Deductible in the business year in which damage or loss occurs</p>	<p><b>(Objective)</b></p> <p>✓ Rationalize timing of deduction for impairment loss</p> <p><b>(Content)</b></p> <p>✓ Impairment loss is deductible not only in the business year in which damage or loss occurs, but also in the business year in which the damage or loss is confirmed</p> <p><b>(Effective Date)</b> Effective for a tax year commencing on or after January 1, 2019</p>

## 3. Rationalize Criteria for Determination of Foreign Corporation *[Enforcement Decree of the Corporate Income Tax Law §1]*

Current	Amendment
<p><input type="checkbox"/> Criteria for Determination of Foreign Corporation*</p> <p>* In case of an overseas investment vehicle ("OIV"), despite the fact that it is not treated as a corporation in the country of residence, it shall be treated as a foreign corporation due to the "subject of rights and obligations" standard</p> <p>An organization shall be treated as a foreign corporation if one or more of the following criteria is met :</p> <ul style="list-style-type: none"> <li>- An organization that owns an asset, becomes a party to a lawsuit, or directly holds a right or owes an obligation, independent of its members</li> </ul>	<p><b>(Objective)</b></p> <p>✓ For a foreign organization that does not have characteristics of corporation, such as partnership, in order to tax the members of the organization (investors) based on the substance, modify criteria for determination of foreign corporation</p> <p><b>(Content)</b></p> <p>✓ The subject of rights and obligations standard has been deleted</p> <p><b>(Effective Date)</b> Effective for a tax year commencing on or after January 1, 2020</p>

## III. Enforcement Decree of the Tax Incentive Limitation Law

### 1. Requirements of Special Tax Provision for Accelerated Depreciation of Capital Expenditure *[Enforcement Decree of the Tax Incentive Limitation Law §25-3]*

Current	Amendment
<p>&lt;Newly Enacted&gt;</p>	<p><b>(Objective)</b></p> <p>✓ Promote corporate investments</p> <p><b>(Content)</b></p> <p>✓ Scope of mid-sized firm</p>

Current	Amendment
<Newly Enacted>	<ul style="list-style-type: none"> <li>- A corporation with average annual sales of less than KRW 300 billion for the immediately preceding three taxable years</li> </ul> <p>✓ Scope of applicable assets</p> <ul style="list-style-type: none"> <li>- Fixed Assets for business use (Enforcement Decree of the Corporate Income Tax Law §28⑥) <ul style="list-style-type: none"> <li>■ Machinery and equipment, tools, and furniture and fixtures</li> <li>■ Automobiles and delivery equipment and vessels and aircraft (only for the direct use in transportation and leasing businesses)</li> </ul> </li> <li>- Assets invested in innovative growth industry <ul style="list-style-type: none"> <li>■ Investment in facilities for commercializing new growth technologies (Tax Incentive Limitation Law §25-5)</li> </ul> </li> </ul> <p>✓ Deduction method</p> <ul style="list-style-type: none"> <li>- A corporation can select and report the useful life within the range determined by adding and subtracting 50/100 of the standard useful life</li> </ul> <p><b>(Effective Date)</b> Effective for fixed assets acquired on or after July 1, 2018</p>

**2. Establish National Tax Service's Advance Review System for R&D Tax Credits** *[Enforcement Decree of the Tax Incentive Limitation Law §9⑬]*

Current	Amendment
<Newly Enacted>	<p><b>(Objective)</b></p> <p>✓ Alleviate taxpayer's compliance costs related to R&amp;D tax credits</p> <p><b>(Content)</b></p> <p>✓ Establish the National Tax Service's advance review system for R&amp;D tax credit</p> <ul style="list-style-type: none"> <li>- (Subject to review) Advance review of items related to general/new growth R&amp;D expenses</li> <li>- (Operations) To be determined by the Commissioner of the National Tax Service</li> </ul> <p><b>(Effective Date)</b> Effective for a tax year commencing on or after January 1, 2020</p>

## IV. Enforcement Decree of the Value-Added Tax Law

### 1. Extend Due Date of Tax Invoice Receipt for Input Value-Added Tax ("VAT") Deduction [Enforcement Decree of the Value-Added Tax Law §75 (7)]

Current	Amendment
<p><input type="checkbox"/> A tax invoice is deductible as input VAT if such invoice is issued until the due date of the final return for the taxable period in which the supply time falls</p> <p>&lt;Newly Enacted&gt;</p>	<p><b>(Objective)</b></p> <p>✓ Extend due date of tax invoice receipt for input VAT deduction</p> <p><b>(Content)</b></p> <p>✓ In case where a tax invoice is issued within six months of the due date of the final return for the taxable period in which the supply time falls, if an amended tax return or a refund claim is filed, or if the head of the relevant tax office makes a determination or correction, an input VAT deduction shall be allowed.</p> <p>✓ Basis for input VAT deduction :</p> <ul style="list-style-type: none"> <li>- In case where a tax invoice is issued after the due date of the final return for the taxable period in which the supply time falls, if the tax invoice is issued within six months after the due date of the final return for the taxable period in which the supply time falls and any of the followings is met</li> <li>■ An amended tax return or a refund claim for the taxable period is filed along with the issued tax invoice</li> <li>■ The head of the relevant tax office makes a determination or correction as the fact of the transaction is verified</li> </ul> <p><b>(Effective Date)</b> Effective on the date of promulgation</p>

### 2. Allow Input VAT Deduction for Tax Invoice with Error in Supply Time [Enforcement Decree of the Value-Added Tax Law §75 (8)]

Current	Amendment
<p>&lt;Newly Enacted&gt;</p>	<p><b>(Objective)</b></p> <p>✓ Allow an input VAT deduction where a tax invoice is issued before supply of goods or services, but such goods or services are supplied within 30 days of the issuance of the invoice, if the head of the relevant tax office makes a determination or correction after verifying the fact of the transaction</p>

Current	Amendment
<p>&lt;Newly Enacted&gt;</p>	<p><b>(Content)</b></p> <p>✓ Basis for input VAT deduction</p> <ul style="list-style-type: none"> <li>- In case where a tax invoice is issued before supply of goods or service, but such goods or services are supplied within 30 days of the issuance of the invoice, if the head of the relevant tax office makes a determination or correction after verifying the fact of the transaction</li> </ul> <p><b>(Effective Date)</b> Effective on the date of promulgation</p>

**3. Allow Input VAT Deduction for Error in Determination of Consignment Sales [Enforcement Decree of the Value-Added Tax Law §75 (9),(10)]**

Current	Amendment
<p>&lt;Newly Enacted&gt;</p>	<p><b>(Objective)</b></p> <p>✓ Allow an input VAT deduction where the substance of transaction is a sale of goods on consignment but is not regarded as such per the contract, or where the substance of transaction is not a sale of goods on consignment but is regarded as such for issuance of the tax invoice, if the fact of the transaction is verified and the contracting party reports and pays the tax due</p> <p><b>(Content)</b></p> <p>✓ Basis for input VAT deduction</p> <ul style="list-style-type: none"> <li>- In case where the substance of transaction is a sale of goods on consignment or a sale through an agent but is not regarded as such per the contract, if the fact of the transaction is verified on the basis of the issued tax invoice, and the tax due for the taxable period is reported and paid to the head of the relevant tax office</li> <li>- In case where the substance of transaction is not a sale of goods on consignment or a sale through an agent but is regarded as such for issuance of the tax invoice, if the fact of the transaction is verified on the basis of the issued tax invoice, and the tax due for the taxable period is reported and paid to the head of the relevant tax office</li> </ul> <p><b>(Effective Date)</b> Effective on the date of promulgation</p>

**4. Revise Taxable Period Eligible for Consolidated VAT Payment at Principal Place of Business** [Enforcement Decree of the Value-Added Tax Law §29③]

Current	Amendment
<ul style="list-style-type: none"> <li><input type="checkbox"/> If a taxpayer commences its business at an additional place of business, it shall be eligible for a consolidated VAT payment at the principal place of business from the taxable period following the date of commencement at the additional place of business</li> </ul>	<p><b>(Objective)</b></p> <ul style="list-style-type: none"> <li>✓ Improve taxpayer's convenience</li> </ul> <p><b>(Content)</b></p> <ul style="list-style-type: none"> <li>✓ If a taxpayer commencing its business at an additional place of business files an application for a consolidated VAT payment within 20 days of the date of commencement at the additional place of business, it shall be eligible for a consolidated VAT payment from the taxable period in which the date of commencement at the additional place of business falls</li> </ul> <p><b>(Effective Date)</b> Effective on the date of promulgation</p>

**V. Enforcement Decree of the Individual Income Tax Law**

**1. Improve Foreign Tax Credit Regime** [Enforcement Decree of the Individual Income Tax Law §117]

Current	Amendment
<ul style="list-style-type: none"> <li><input type="checkbox"/> "Foreign income taxes prescribed by the Presidential Decree" mean any of the following tax amounts (excluding penalties and surcharges) assessed by a foreign government</li> </ul> <p>Foreign tax credit limitation</p> $= \text{Aggregate income taxes or retirement income taxes} \times (\text{foreign source income} - \text{amount of foreign source income prescribed by the Ordinance of the Ministry of Economy and Finance}) / \text{aggregate income of the relevant tax year}$	<p><b>(Objective)</b></p> <ul style="list-style-type: none"> <li>✓ Improve foreign tax credit regime by clarifying the scope of foreign income taxes subject to credits, the concept of direct/indirect expenses to be deducted from foreign source income calculation, and the calculation of foreign taxes related to direct/indirect expenses, which should be excluded from foreign tax credit carryforwards</li> </ul> <p><b>(Content)</b></p> <ul style="list-style-type: none"> <li>✓ "Foreign income taxes prescribed by the Presidential Decree" mean any of the following tax amounts (excluding penalties and surcharge) that are paid or payable to a foreign government. However, the amounts in excess of the taxes calculated in accordance with the provisions of non-taxation, exemption, or reduced tax rate under the Treaty shall be excluded.</li> <li>✓ For foreign tax credit limitation calculation purposes, "Foreign source income" shall be the amount obtained by deducting the following direct and indirect expenses, which are deducted as necessary expenses (excluding the necessary expenses deducted for taxation in the country where the foreign source income is generated) for purposes of calculating aggregate income of the relevant tax year and are corresponding to the foreign source income</li> </ul>

Current	Amendment
	<ul style="list-style-type: none"> <li>■ Direct expenses : expenses that are not treated as the indirect expenses under the subparagraph 2 below and are directly corresponding to the foreign source income</li> <li>■ Indirect expenses : expenses that are related to both the foreign source income and the other income and are calculated in accordance with the method prescribed by the Ordinance of the Ministry of Economy and Finance</li> </ul> <p>(Effective Date) Effective on the date of promulgation</p>

## VI. Enforcement Decree of the National Tax Basic Law

### 1. Reduce Scope of Secondary Tax Liability of Acquirer [Enforcement Decree of the National Tax Basic Law §22]

Current	Amendment
<ul style="list-style-type: none"> <li>□ In case of a business transfer where the transferor's properties are insufficient to cover the national taxes and the disposition fees for delinquency of the business, for which the transferor's tax liability becomes final before the transfer date, the acquirer who comprehensively succeeds all rights and obligations of the business shall assume the secondary tax liability for the shortage to the extent of the value of the transferred properties.</li> </ul>	<p><b>(Objective)</b></p> <ul style="list-style-type: none"> <li>✓ Reduce the scope of secondary tax liability to an acquirer who comprehensively succeeds all rights and obligations of a business and is related to the transferor or acquires the business for the transferor's tax evasion</li> </ul> <p><b>(Content)</b></p> <ul style="list-style-type: none"> <li>✓ A person who comprehensively succeeds all rights and obligations of a business and meets any of the following shall assume the secondary tax liability <ul style="list-style-type: none"> <li>■ A person related to the transferor</li> <li>■ A person who acquires the business for the transferor's tax evasion</li> </ul> </li> </ul> <p>(Effective Date) Effective for a business transfer after the date of promulgation</p>



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