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Korean Tax Brief

Update on Current Issues and Trends

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1. The provision on the reduced tax rate under the tax treaty itself cannot be viewed as tax reduction provision of the country where the income is sourced (Josim2017Boo2711, 2017.08.09.).

In a recent tax tribunal case, a company received dividend income from its subsidiary in China and filed a corporate income tax return by applying direct foreign tax credit for the taxes withheld at 5% in China in accordance with the Korea-China tax treaty. However, in addition to this direct foreign tax credit, the company claimed that the amount corresponding to 5% of the dividend income, which is the difference between the 5% reduced tax rate under the Korea-China tax treaty and 10% tax rate under Article 5(1) of the second protocol to the tax treaty, should be subject to deemed foreign tax credit for Korean tax purpose.

The deemed foreign tax credit is a regime which the tax amount equivalent to the tax exempted in the contracting country of the tax treaty are deemed to have been actually paid and allows tax credits in order to preserve the effect of tax exemptions for the promotion of economic development carried out by the capital importing country and its purpose is to attribute the tax reduction effect of the capital importing country virtually to foreign investors. Thus, it is applied on the assumption of China's abandonment of taxation (reduction and exemption) by prescribing the provision concerning tax incentives (the domestic law which will grant higher exemption than the reduced tax rate).

However, there is no tax rate under the Chinese tax laws that is lower than the reduced tax rate of the Korea-China tax treaty, and China has imposed taxes on dividend income received by non-resident companies at the rate of 10% under its domestic tax laws since the revision of the Corporate Income Tax Law on January 1, 2008, and therefore, China has not abandoned the taxation right of dividends. Further, since the reduced tax rate under a tax treaty establishes the scope of the taxation right of the country in which income is sourced with respect to the dividend income, the provision of the tax treaty that defines the reduced tax rate (i.e., Article 10(2)-a of the Korea-China tax treaty) itself cannot be seen as a reduction provision under China's domestic tax laws.

Accordingly, even if the corporate income tax of 5% is paid in China based on the reduced tax rate, the difference between the 5% reduced tax rate under the Korea-China tax treaty and 10% tax rate under Article 5(1) of the second protocol to the tax treaty should not be subject to the deemed foreign tax credit rules in Korea.

2. The starting date of the requesting period of the refund request must be the day when the taxpayer becomes aware of relevant event occurring, and not the day when the taxpayer becomes aware of the court case which changes the interpretation of the relevant transaction. (Supreme Court 2017.8.23. Declared2017Doo38812Judged)

Article 45-2(2) of the former Basic National Tax Law ("BNTL") stipulates that in certain case of the subsequent event as prescribed ("subsequent event" or "subsequent ground") in the BNTL occurs, a taxpayer can request for a refund within two months from the date on which he/she becomes aware of occurrence of such event. Since the refund request filed after the required deadline is invalid, the tax authority is not obliged to determine or correct a tax base and tax amount or to reject the request for refund. Thus, even if the tax authority refuses to correct it, such case cannot be subject to appellate litigation.

The above refund request is generally made based on subsequent events or grounds which had not occurred at the time of initial declaration or tax assessment. Therefore, if the existence of the transaction or legal effect for the transaction that becomes the basis for calculating the tax base and the tax amount has changed, such situation may fall under the subsequent events set forth in the former BNTL. However, the change of the interpretation of the law from the time of the initial declaration/decision does not fall under such subsequent events. As such, if the taxpayer requests for a refund on the grounds of the existence of the subsequent event, the starting date of the requesting period of the refund request must be the day when the taxpayer becomes aware of relevant event occurring, not the day when the taxpayer becomes aware of that the court case which changes the interpretation of the relevant transaction.

3. Even if the extension of the corporate tax return deadline is approved, it does not mean the extension of the local income tax deadline has been approved as such authority lies with the head of the relevant local government (Josim2016Ji1186, 2017. 8. 9.)

The local income tax is prescribed as an independent tax item of which the taxation entity and procedures, taxation requirements, etc. are different from the corporate income tax, which is a national tax. As such, the authority to approve such extension of local income tax return is the head of the local government, and even if a company obtains an approval on the extension of the corporate tax return deadline from the competent tax office, it does not mean that the deadline for the local income tax return is also extended.

4. The deadlines for tax return/payment of withholding tax, securities transaction tax are extended for three days next month.

The National Tax Service ("NTS") announced on September 11 that a statutory deadline for various taxes such as withholding tax, securities transaction tax, and issuance of electronic tax invoices will be extended from October 10(*) to October 13. This is because a long-term holiday starting from September 30 will continue until October 9 and taxpayers are expected to experience inconvenience in handling various taxes as working days have reduced.

An official of the NTS stated that as the deadlines for the various tax filing and payment are extended, taxpayers are given enough time to declare, pay, issue and submit various taxes after the Thanksgiving holidays.

(*)September 30 lands on a Saturday, and therefore the filing/payment deadline is automatically extended to the next business day (October 10)

5. Tax avoidance of multinational companies will be resolved during this year

The government plans to legislate the "OECD BEPS project" within this year to prevent tax avoidance of multinational companies. On August 30, the Ministry of Strategy and Finance ("MOSF") presented the "Medium and Long-Term Tax Policy Management Plan" including such legislation plan. The BEPS (Base Erosion and Profit Shifting) project is an international cooperative countermeasures prepared by the OECD and G20 at the G20 Summit held in November 2015. The countries that participate in the project assured to gradually reflect the measures for tax avoidance from the 2016 revision bill of the tax law and Korea has also participated in this project.

Specifically, domestic companies and Korean branches of foreign corporations whose annual sales exceed 100 billion won and transaction amounts with foreign related party exceed 50 billion won must report both 'Local File' and 'Master File'. Local File will include current state of related party transactions and transfer pricing information. Master File will include the overall structure of multinational company. The monitoring network of the international community will be strengthened as the submission of the country-by-country report, which includes business information and tax payment history of multinational companies around the world, becomes mandatory. The Korean government stated in the report that concerns of international tax avoidance schemes such as using the differences between tax laws among countries has increased with the growth of international transactions which resulted from expansion of FTAs among countries and capital liberalization. Therefore, it has set the domestic legislation for introduction and implementation of the OECD BEPS countermeasure system as a to-do list for this year.

In addition, the government plans to supplement the taxation system for digital transactions, reflecting the trend of international debate over the long term. Moreover, it plans to adjust the scope of domestic source income of non-residents and foreign corporations, and improve the taxation system of foreign source income of residents and domestic corporations. Besides this, the government also plans to increase taxation support for foreign investments and promote amendment of the tax treaty reflecting the changing circumstances such as international standards and investment amount. The measures to strengthen international cooperation such as financial information exchange will also be prepared. The MOSF stated that the demand for tax treaty amendment is continuously expanding due to an increase in overseas investment, etc. and the need for tax cooperation among countries to enhance international tax revenue management is also increasing.

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