Notable Proposed Tax Law Amendments

On July 25, 2019, the Ministry of Economy and Finance released its proposed tax amendments for 2019 (the “Proposed Amendments”), which if finalized and enacted by the National Assembly, would be effective from 2020. With focus on achieving tax equity and tax rationalization and increasing tax revenue, the Proposed Amendments appears to have taken into consideration provision of economic incentives for businesses to develop innovative businesses and efforts to stimulate the Korean economy.

The Proposed Amendments are expected to be reviewed by the relevant authorities and submitted to the National Assembly on September 3 of this year. It is subject to changes during the review process. Once finalized and passed by the legislature (this usually takes place in December), the amended law would be effective from January 1, 2020.

Below, we have outlined some of the amendments that may be relevant for companies or individuals, including foreign invested companies, Korean companies, or individuals involved in cross-border transactions, and foreign companies or individuals that frequently do business with a Korean company or individual, as attached.

We hope this newsletter gives you a general understanding of what types of tax amendments to expect for the upcoming year.

1. International Tax

A. Rationalize the party bearing the burden of proof on backdoor transactions: Where a backdoor transaction results in a reduction in domestic tax burden by the amount stipulated under the Presidential Decree (“PD”) (e.g., 50%), the Proposed Amendments would place the burden of proving that there was no intent of tax avoidance on the taxpayer (applicable to fiscal years commencing on 1 January 2020).

B. Unify the refund claim rights of a non-resident individual or foreign corporation: Rules concerning a refund claim of a non-resident or foreign corporation subject to withholding are currently provided under the National Tax Basic Law (the “NTBL”), Corporate Income Tax Law (the “CITL”), and Individual Income Tax Law (the “IITL”), respectively. The Proposed Amendments delete those under the NTBL, leaving relevant provisions under the CITL and IITL as unified rules concerning the refund claim right of a non-resident individual or foreign corporation while placing the burden of proof on the taxpayer (applicable to relevant income arising on or after 1 January 2020).

C. Strengthen penalty for non-submission of information/data pertaining to international transaction: Under the Proposed Amendments, non-submission of information/data requested by the tax authorities (e.g., schedule of international transactions, Master File/Local File/Country-by-Country report (collectively referred to as “BEPS reports”)) would be subject to a penalty up to KRW
300 million every 30 days until satisfactory submission thereof (applicable to fiscal years
commencing on or after 1 January 2020).

**D. Newly establish provisions for presumptive transfer pricing assessment in case of non-
submission of information/data pertaining to international transaction:** The Proposed
Amendments introduce provisions that would allow the tax authorities to impose transfer pricing
assessment based on the arm’s length price presumed through the data collected from comparable
companies within the same industry if the taxpayer does not submit the requested information/data
(e.g., schedule of international transactions, BEPS reports, etc.) (applicable to fiscal years
commencing on or after 1 January 2020).

**E. Eliminate duplicate submission of information/data pertaining to international transaction:**
Under the Proposed Amendments, a corporation subject to Master File/Local file submission would
be exempt from the submission requirement of schedule of international transactions and reporting
of transfer pricing method applied (applicable to fiscal years commencing on or after 1 January
2020).

**F. Clarify the scope of capital gains subject to taxation in Korea under the Korea-U.S. Tax
Treaty (e.g., domestic real-estate, etc.):** The Proposed Amendments add “real-estate securities”
to the definition of “real-estate” under Korea-U.S. Tax Treaty, clarifying domestic taxing right on
capital gains from real-estate securities.

**G. Improve taxation system on domestic source royalty for the use of patents not registered in
Korea:** Under the Proposed Amendments, any manufacturing know-how, technical information, etc.,
included in a patent not registered in Korea used for domestic manufacturing, production, etc. will
be deemed as “remuneration for other similar property, rights” under the Treaty and classified as
royalty income. Further, indemnity for infringement of patents registered overseas (but not
registered in Korea) will be classified as other income (subject to 16.5% tax rate including the local
income tax) (applicable to income paid on or after 1 January 2020).

2. **Corporate Income Tax**

**A. Adjustment to special tax regime for in-kind contribution upon establishment/conversion of
a holding company:** Under the Proposed Amendments, when an in-kind contribution is made to
establish a holding company, any corporate income tax/capital gains tax that may arise from such
transaction shall be paid in installments over three years starting from the 5th fiscal year after the in-
kind contribution is made (applicable to in-kind contributions/transfers of shares occurring on or
after January, 1, 2022).

**B. Reduced scope of entities subject to the Promotion of Investment·Mutual Cooperation Tax:**
Under the Proposed Amendments, the Promotion of Investment·Mutual Cooperation Tax will not be
applicable to special purpose companies (applicable to fiscal years commencing on or after January 1, 2020).

C. **Loosened requirements for deductible car expense incurred for business purposes:**
Under the Proposed Amendments, taxpayers are entitled to a deduction up to KRW 15 million (previously KRW 10 million) for car expense incurred for business purposes without any records (applicable to fiscal years commencing on or after January 1, 2020).

D. **Decreased in threshold for de minimis safe harbor:** Under the Proposed Amendments, taxpayers will be allowed to immediately deduct expenditures made for certain purposes up to KRW 6 million (previously KRW 3 million) per item.

E. **Clarification on tax treatment for leases** (amendment to the PD): Regardless of whether the accounting treatment for existing leases is changed, the current tax treatment for leases should continue to be applied (i.e., depreciation on the financial leases can be claimed by the lessee, and depreciation on operating leases can be claimed by the lessor).

F. **Clarification on the scope of amount subject to the penalty for fraudulent or incorrect VAT invoice:** The Proposed Amendments clarify that where a penalty is imposed for fraudulent or incorrect VAT invoice, etc., issued in connection with goods and services supplied, the amount that should be subject to the 2% penalty is limited to the amount that is deductible for tax purposes.

### 3. Individual Income Tax

A. **Enactment of exemption provisions on administrative fine for failure to report foreign accounts:** Under the Proposed Amendments, an administrative fine for failure to report foreign accounts will be waived to the extent where a taxpayer is subject to a criminal fine or administrative fine under a “notice disposition” (notice dispositions are issued to taxpayers whose unlawful act is likely to result in a criminal fine, and compliance with the notice dispositions would by themselves terminate the actual and potential criminal proceedings). The relief is designed to lessen burden on taxpayers who are subject to simultaneous imposition of criminal fines and administrative fines, considering that the administrative fine under a notice disposition is an administrative measure that appears to be equivalent to the criminal fine (applicable to notice dispositions issued on or after January 1, 2020).

B. **Increased range of the penalty reduction ratio for late or amended reporting of foreign financial accounts:** Under the Proposed Amendments, with respect to late or amended reporting of foreign financial accounts, the range of the penalty reduction ratio will be increased to 30% ~ 90% from 10% ~ 70% (applicable to late or amended reporting filed on or after the effective date of the relevant provisions).
C. **New limitation on earned income deduction:** While a taxpayer is entitled to a deduction from his or her earned income, the allowed deduction will be limited to KRW 20 million. (applicable to income received on or after January 1, 2020).

D. **Reduction of severance pay limit for officers:** Under the Proposed Amendments, the amount of severance pay that officers are entitled to on or after January 1, 2012 will be calculated based on a less favorable formula (see below) with downward adjustment of the applicable statutory number from 3 to 2: (average annual total wage for the 3 years preceding retirement x 10% x consecutive years of employment since January 1, 2012 x *applicable statutory number) (applicable to severance pay received on or after January 1, 2020).

4. **VAT**

A. **Loosened requirements for deferred VAT payment on purchase of imported goods:** If certain requirements are met, the VAT Law (the “VATL”) allows for small-medium sized enterprises (“SME”(s)) that are in the manufacturing business to defer VAT payment on their purchase of imported goods. One of the requirements for such deferred payment was that the taxpayer must not have any record of delayed VAT payment within the last two years. However, the Proposed Amendments allows for the taxpayer to still meet this requirement if such delayed payment was made within 15 days from the payment due date.

B. **VAT credit afforded to accounts receivables or other receivables that are ascertained as bad debt:** Whereas a VAT credit is afforded to taxpayers with accounts receivables or other receivables that are ascertained as bad debt within 5 years of the supply date, the Proposed Amendments allow such VAT credit for taxpayers for which accounts receivables or other receivables are ascertained as bad debt within 10 years from the supply date.

C. **Reduced penalty burden for taxpayers with more than one registered place of business for VAT purposes:** Under the current rules, taxpayers with more than one registered place of business for VAT purposes are subject to a penalty at the rate of 2% of the supply value where the taxpayer fails to issue a VAT invoice from the proper place of business (from which the goods or services were supplied) and instead issues the VAT invoice from another place of business (the law treated such error as non-issuance and applied a 2% penalty). Under the Proposed Amendments, such erroneous issuance of VAT invoice shall only be subject to a 1% penalty of the supply value.

D. **Prevention of duplicative penalties on erroneous VAT invoices:** Where a penalty is imposed for erroneously indicating a supply value that is in excess of the actual supply value (penalty at the rate of 2% of the supply value), the law was ambiguous as to whether the penalty for failure to correctly indicate the “necessary information” within the VAT invoice should also be imposed (penalty of 1% of the supply value) (supply value is one of the “necessary information” that is subject to the 1% penalty).
The Proposed Amendments make it clear that the 1% penalty for erroneous indication of “necessary information” should not be imposed in addition to the 2% penalty imposed for indicating a supply value in excess of the actual value.

E. Clarification on the scope of VAT credit denied for failure to correctly indicate “necessary information” within the VAT invoice: The Proposed Amendments clarifies that where a taxpayer is denied a VAT credit for failing to correctly indicate the correct supply value, the amount of VAT credit that should be denied is the amount that corresponds to the difference between the erroneous supply value and the proper supply value rather than the amount corresponding to the entire supply value.

5. Amendments in the NTBL and other tax regimes

A. Reduction of Securities Transaction Tax (“STT”): Under the Proposed Amendments, STT applicable to the transfer of shares (both listed and non-listed shares) outside the stock exchange is reduced from 0.5% to 0.45%.

B. Amended tax returns allowed for tax returns that were filed after the filing due date: While taxpayers are currently not allowed to file amended tax returns on its past tax returns that were filed after the statutory due date, the Proposed Amendments now allow for such amended returns (i.e., refund requests and request for correction of taxes) to be filed even if the taxpayer had submitted its initial tax return past its statutory due date.

C. Amendments to premiums applied on the value of shares owned by the largest shareholder: Under the Proposed Amendments, when valuing the shares owned by the largest shareholder, the largest shareholder shall be applied with a 20% premium in determining the value of its shares, unless the shareholder is a SME in which case no premium shall be applied.

6. Customs Duties

A. Expansion of duty exemption on re-import: Customs duties may be exempted where exported goods are re-imported due to defects in the goods within 1 year after export declaration, or where tools attached to exports for quality maintenance/status check during transportation or equipment used temporarily for installment/assembly/unloading are re-imported within 2 years from the date of export declaration (applicable to import declaration filed on or after January 1, 2020).

B. Enactment of special provisions for extension of time to file an ex post facto application for preferential tariff under a Free Trade Agreement (“FTA”): An ex post facto application for preferential tariff under a FTA will be allowed for 45 days from the date of payment notice of customs duties when imported goods are reclassified under HS code which is different from the HS
code declared by the importer (applicable to ex post facto applications for preferential tariff filed on or after April 1, 2020).