YULCHON Attorneys at Law

LEGAL UPDATE

International Tax

August 2021

2021 Proposed Tax Law Amendments - International Tax

The Ministry of Economy and Finance announced the proposed amendments to the tax law last week.

We have prepared a summary of the parts relating to international taxation below. This summary is divided into three categories - "measures to strengthen the tax administration for international transactions", "changing the administration or procedures of the international tax regime", and "improving taxpayer convenience" - and also analyzes the expected effect of the proposed amendments from the taxpayer's perspective. Once passed into law at the National Assembly by the end of the year, most provisions would become effective from January 1, 2021.

1. Measures to strengthen the tax administration for international transactions

(1) Obligation to submit data relating to the current status of liaison offices of foreign corporations (Newly introduced in Article 94-2 of the Corporate Income Tax Act ("CITA"))

Currently, there is no provision mandatorily requiring the reporting of the current status of liaison offices and Korean branches of foreign corporations. However, going forward, a new provision will be introduced in the CITA and current status data such as the basic information about foreign corporations' liaison offices (e.g. personal information of the representative), current status of the foreign head office and other Korean branches, and information on Korean transaction parties will need to be submitted by February 10 of the following taxable year. This new provision applies to current status data submitted for the taxable year commencing on or after January 1, 2022.

It is expected that the introduction of this new provision in the CITA will lead to an increase in tax audits on permanent establishments and in corporate income tax and value added tax ("**VAT**") assessments by the tax authorities, including an increase in examination of cases where a foreign corporation conducts major business activities through its liaison office in Korea but does not file tax returns or pay taxes on the Korean-sourced income.

(2) Expansion of the scope of foreign corporations subject to the controlled foreign corporation ("CFC") taxation regime (Article 27 of the Law on the Coordination of International Tax Affairs ("LCITA"))

Under the current law, the CFC regulations apply to foreign corporations that have an effective tax rate of 15% or less in the relevant foreign country and has a special relationship with a Korean corporation or individual (a Korean corporation or individual owns at least 50% of the voting stock in the foreign corporation).

Going forward, the threshold for the effective tax rate will be increased to 70% of the maximum corporate income tax rate (25%) in Korea (i.e. effective tax rate 17.5% or less). A further amendment is expected for inclusion of "trusts subject to corporate taxation" (special purposes trusts, trusts for issuance of beneficiary certificates and limited liability trusts under the Trust Act) in the scope of foreign corporations to which the CFC regime applies.

The proposed amendment applies to taxable years commencing on or after January 1, 2022. Taxpayers should keep in mind that overseas subsidiaries with an effective tax rate between 15% and 17.5% (that have been outside the scope of the CFC regime) will be subject to the CFC regime from next year.

(3) Establishment of new standards on reduction of administrative penalties for late submission of international transaction documents (Article 100 of the Presidential Decree to the LCITA)

Under the current law, there are provisions on administrative penalties for failure to submit international transaction documents (e.g. master file, local file and country-by-country report) after the filing due date, or for submission of false international transaction documents; however, there is no provision on reduction of such administrative penalties upon submission of amended documents or submission of relevant documents after the filing due date.

Going forward, it is expected that these administrative penalties will be reduced by 30-90% in cases where amended international transaction documents are submitted before the penalty is imposed or where international transaction documents are submitted after the filing due date. However, the foregoing will not apply to cases where the taxpayer submits relevant documents after becoming aware in advance of the imposition of administrative penalties by the tax authorities. The proposed amendment applies to documents submitted on or after the date of enforcement of the Presidential Decree. In the future, it is expected that the tax authorities will make more information/document requests in order to secure information about transactions with foreign affiliates.

(4) Introduction of a new document submission obligation for taxpayers holding overseas real property (Article 58(1) of the LCITA and Article 98(1) of the Presidential Decree to the LCITA)

Under the current law, Korean residents and domestic corporations that acquire, invest and operate (i.e. lease), or dispose of overseas real property are obliged to submit relevant documents to the tax authorities; however, there is no document submission obligation if a Korean resident or domestic corporation simply holds overseas real property and does not lease it to anyone.

Going forward, Korean residents and domestic corporations simply holding overseas real property will also be required to submit the details of the overseas real property held. For failure to submit such details or for false submission, an administrative penalty equivalent to 10% of the property acquisition price will be imposed. The new obligation applies to documents submitted on or after January 1, 2022, and administrative fines will be imposed for non-compliance occurring on or after January 1, 2023.

This proposed amendment is expected to strengthen the tax authorities' management of revenue sources in connection with overseas real property.

(5) Introduction of an obligation to maintain and submit transaction statements for overseas businesses supplying electronic services (Article 53-2 of the Value-Added Tax Act ("VATA"))

The current VATA requires overseas service providers supplying electronic services (e.g. games, applications, music, video, software, and cloud services) in Korea to register as a simplified business person and pay VAT; however, unlike Korean business persons, the VATA does not impose an obligation on overseas businesses to issue tax invoices or to maintain and submit transaction data.

Going forward, an overseas service provider that has registered as a simplified business person in Korea will be required to maintain the details of its electronic service transactions for 5 years from filing the final tax return. The VATA will be amended such that the Commissioner of the National Tax Service ("**NTS**") can request overseas service providers to submit their transaction details (e.g. type of service provided, person who received the service, transaction amount, transaction volume, time of supply of service), and the overseas service provider receiving such request must submit a transaction statement within 60 days from the date of receiving such request.

The proposed amendment applies to electronic services supplied on or after July 1, 2022. Through examination of the data submitted by overseas service providers, the tax authorities are expected reinforce the management of its revenue sources relating to overseas service providers.

(6) Grounds for cancellation of the simplified business registration of overseas service providers (Article 53-2 of the VATA)

Currently, there are provisions on overseas service providers that are required to complete a simplified business registration and the due date for registration, but there is no provision on cancellation of such registration. As a result of the proposed amendment, the Commissioner of the NTS can cancel the simplified business registration of overseas service providers if they cease their business in Korea.

The proposed amendment applies from January 1, 2022. The introduction of a new cancellation provision is expected to strengthen the management of revenue resources in relation to overseas service providers supplying electronic services in Korea.

(7) Increased sanctions against violation of the obligation to submit customs duty data by multinational enterprises (Article 277 of the Customs Act)

Under the current law, an administrative penalty not exceeding KRW 100 million may be imposed for non-submission or false submission of data on the determination of customs duty where the purchaser is a related party. Going forward, the authorities will be able to request submission of relevant data and to request correction within 30 days after imposing an administrative penalty. If the taxpayer does not comply with such request, an additional administrative penalty of up to KRW 200 million can be imposed depending on the period of delay, such that the total maximum penalty will be KRW 300 million.

The proposed amendment applies to submission requests made for the first time on or after January 1, 2022. Given the upward adjustment of the maximum penalty amount, the Korean domestic corporations or branches of multinational enterprises should pay more attention to submission of data relating to their foreign affiliates.

2. Changing the administration or procedures of the international tax regime

(1) Changes to the provisions on foreign tax credits/refunds for qualified investment vehicles (Article 129(4) of the Personal Income Tax Act (“PITA”), Articles 57(1), 73(1), and 57-2 of the CITA)

Under the current law, where investment trusts, investment companies, investment-purpose companies, investment partnerships, etc. under the Capital Markets and Financial Investment Services Act (“**qualified investment vehicles**”) incur taxes overseas in relation to their overseas investments, they receive a tax credit or refund (up to 14% of the overseas investment income) from the Korean government, which has an effect of eliminating international double taxation. Subsequently, when the income is actually distributed to the investors, taxes are withheld from the relevant income at the domestic tax rate (i.e. 14%).

Going forward, the foreign tax credit/refund system for qualified investment vehicles will be abolished. Instead, when qualified investment vehicles distribute investment returns to their investors, taxes shall be withheld after deducting the foreign taxes paid. In respect of investment returns derived by corporate investors which are not subject to withholding tax, the law will be amended such that corporate investors can claim tax credits for the foreign taxes paid by qualified investment vehicles at the time of filing their corporate income tax returns. The proposed amendments should not change the tax burden for investors of qualified investment vehicles, but are expected to relieve asset managers from the administrative burden of having to submit tax refund applications, etc.

(2) Clarification of the requirements for treating an overseas investment vehicle ("OIV") as the beneficial owner and the relationship with tax treaties (Article 119-2(1) of the PITA and Article 93-2(1) of the CITA)

Currently, an OIV can be treated as the beneficial owner of Korean-sourced income if it satisfies one of the following requirements: (i) the OIV is liable to tax in its country of residence and does not have a purpose to avoid personal income or corporate income tax, (ii) the OIV is recognized as the beneficial owner under the relevant tax treaty, or (iii) the OIV fails to identify its investors.

Going forward, for greater consistency between the statutory requirements and tax treaty articles, requirements (i) and (ii) will be amended such that an OIV can be treated as the beneficial owner of Korean-sourced income if: (i) the OIV is a resident (an individual or corporation liable to tax) in the country of establishment in accordance with the relevant tax treaty, and satisfies the requirements for application of tax treaty benefits to the Korean-sourced income, or (ii) the OIV that does not satisfy the amended requirement (i) is recognized as the beneficial owner of Korean-sourced income under a separate provision in the relevant tax treaty and therefore tax treaty benefits are applicable to the Korean-sourced income.

The proposed amendments apply to Korean-sourced income paid on or after January 1, 2022. As the amendments attempt to reflect the tax treaty requirements more clearly (than domestic standards linked to corporate income tax or personal income tax) in the beneficial ownership determination for OIVs, it is expected that the proposed amendments will improve tax certainty for foreign investors.

(3) Supplementation to the scope of actual owner information the tax authorities can request from taxpayers (Article 73 of the Presidential Decree to the LCITA)

Under the current law, the tax authorities can request information relating to the actual owners (within the meaning of the Act on Reporting Specified Financial Transaction Information) from taxpayers such as corporations or other entities (e.g. associations), if those information is necessary for exchanging tax information with a country that has a tax treaty with Korea. In cases where the taxpayer is a trust within the meaning of the Trust Act, the tax authorities can request information on the settlor, trustee, beneficiary, trust administrator, and the person who actually controls the trust.

Going forward, the scope of information that can be requested by the tax authorities will be expanded; in addition to the information that can be requested under the current regulations, in cases where the taxpayer is an entity such as an association that does not have a stock-holding or equity-holding structure, the tax authorities can request information on the representative of the relevant entity and the people who are actually involved in making decisions for the relevant entity. The proposed amendment is intended to reflect the recommendations in the "Peer Review Report on the Exchange of Information" issued by the OECD in July 2020.

The proposed amendment applies to information requests (i.e. requests for information on the actual owners) made on or after the date of enforcement of the Presidential Decree. Going forward, taxpayers should keep in mind that, for non-corporate entities such as associations or trusts, the tax authorities can also exchange information on the actual decision-makers.

(4) Transfer pricing regime under exceptional economic circumstances such as the COVID-19 (Reflecting the OECD's "Guidance on the transfer pricing implications of the COVID-19 pandemic" (December 2020))

① Providing a basis for including loss making businesses in comparable transactions (Newly introduced in Article 15(7) of the LCITA)

Currently, the LCITA does not provide any specific considerations for exceptional circumstances such as the COVID-19, although the transfer pricing regime includes various considerations such as analyzing the taxpayer's business environment and related party transactions, selecting the transfer pricing method, selecting comparable transactions and conducting a comparability analysis such as reasonable adjustments for the differences between the tested party and comparables, and using multiple year data if the impact of certain economic condition or business strategy lasts over a number of years. Going forward, the law will be amended to additionally state that, when applying the transfer pricing method, 'loss making business can be used as comparable transactions depending on the economic circumstances such as an economic depression'.

The proposed amendment applies to determinations and amendments made on or after January 1, 2022. The proposed amendment is expected to ensure a reasonable application of the transfer pricing regime under exceptional circumstances such as the COVID-19.

② Force majeure events taken into consideration when the tax authorities make a determination or amendment based on the arm's length share of costs (Article 9 of the LCITA)

Under the current transfer pricing regime in Korea, where (i) a Korean resident enters into an agreement with a foreign related party with respect to the sharing of the costs, expenses and risks and jointly develops or secures an intangible asset in accordance with such agreement, and

(ii) there is a difference between the resident's share of the costs and the arm's length share of the costs, the tax authorities can make a determination or amendment to adjust for the difference. Going forward, the law will be amended to take into account actual circumstances if the costs, expenses and risks are not shared in accordance with the agreement due to a force majeure event such as a natural disaster.

The proposed amendment applies to determinations and amendments made on or after January 1, 2022. The proposed amendment is expected to ensure a reasonable application of the transfer pricing regime in relation to cost sharing agreements under exceptional circumstances and upon occurrence of force majeure event such as the COVID-19 and large-scale natural disasters.

(5) Clarifying the reasons for issuing certificates of residence (Article 41 of the LCITA)

Currently, the LCITA stipulates that a certificate of residence is issued only if a reduced tax rate applies under a tax treaty. However, in the "Application for Certificate of Residence" form, the purpose of issue includes reasons such as 'other tax treaty application' and 'it is necessary to prove that the applicant is a resident of Korea for tax purposes'.

Going forward, the LCITA will be amended to clearly include the following in the reasons for issuing certificates of residence: 'application of an article in a tax treaty (other than the application of a reduced tax rate)' and 'it is necessary to prove that the applicant is a resident of Korea for tax purposes'.

The proposed amendment applies to certificates of residence issued on or after January 1, 2022, and is expected to clarify the legal basis for issuing certificates of residence.

(6) Specifying the scope of adjusted income and the order of non-deductibility for excess interest ("30% EBITDA" rule) (Article 54(3) of the Presidential Decree to the LCITA)

Under the current LCITA, if a Korean domestic corporation has a loan from a foreign related party, the net interest expense exceeding 30% of the adjusted income (income for the relevant fiscal year + depreciation expense + net interest expense) is treated as non-deductible. Further, if the domestic corporation pays interest on more than one loan with different interest rates, interest paid on the loan with a higher interest rate is treated as non-deductible first.

According to the proposed amendment, the relevant provision will (i) include that, in cases where the adjusted income amount is negative, it shall be regarded as zero, and (ii) clarify that in case where the interest expense includes interest paid on more than one loan with the same interest rate, application shall be based on the order of borrowing date (i.e. interest paid on the loan with a more recent borrowing date is treated as non-deductible first), and for loans with the same interest rate and the same borrowing date, non-deductible interest shall be prorated based on the loan amounts.

The proposed amendment applies to fiscal years commencing on or after January 1, 2022, and is expected to enhance the transparency of the system by clarifying the rules on non-deductibility of excess interest.

(7) Providing the legal basis for stopping tax audit postponement (Article 81-7 of the National Tax Basic Act)

Under the current law, if a taxpayer believes that it would be difficult for the taxpayer to go through a tax audit due to a natural disaster, etc., the taxpayer can request a tax audit postponement by submitting an application for deferral of a tax audit to the relevant tax office and obtaining approval prior to the commencement of the tax audit; that is, if (i) the business is facing extreme difficulty due to a natural disaster such as a fire, (ii) the taxpayer cannot be audited due to an illness, or (ii) if the books/records of the taxpayer are seized by a government agency. Under the proposed amendment, the tax authority can stop a tax audit postponement if the reason for postponement ceases to exist or there is an urgent need such as a need to secure a tax lien, but the tax authority will have an obligation to notify the taxpayer 5 days before the re-commencement of the tax audit (however, if there is an urgent need such as a need to secure a tax lien, the tax authority does not have to notify the taxpayer in advance).

The proposed amendment applies to tax audit postponement applications submitted on or after January 1, 2022. Going forward, taxpayers should keep in mind that, in some cases, the tax authority can suddenly re-commence a tax audit that has been postponed.

3. Improving taxpayer convenience

(1) Specifying the tax withholding requirements for fees paid as remuneration for employees dispatched from a foreign corporation (Article 207-10(1) of the Presidential Decree to the PITA)

Under the current law, if a Korean domestic corporation utilizes employees dispatched from a foreign corporation and the following requirements are satisfied, the domestic corporation withholding tax on employee remuneration at the rate of 19% can replace the filing of a final tax return for employment income: (i) the total fee paid to the foreign corporation (dispatching the employees) exceeds KRW 2 billion per year, (ii) the sales revenue for the immediately preceding fiscal year is at least KRW 150 billion or the total assets for the immediately preceding fiscal year is at least KRW 500 billion, and

(iii) the domestic corporation engages in the business of air transportation, construction, science, technical service, etc. Going forward, the criteria for determining whether the total fee paid as employee remuneration exceeds KRW 2 billion per year will be specified as follows: (i) if the sum of employee remuneration specified in the contract with the foreign corporation dispatching the employees exceeds KRW 2 billion, or (ii) the actual total fees paid as employee remuneration in the immediately preceding year exceeds KRW 2 billion. The proposed amendment applies to fees paid (by the Korean domestic corporation utilizing foreign employees to the foreign corporation dispatching the employees) in the fiscal year commencing on or after January 1, 2022.

The proposed amendment is expected to improve the transparency of the system as it will specify the criteria for determining the total fee paid as employee remuneration as either the remuneration stated in the contract or the fees actually paid in the immediately preceding year.

(2) Extension of the application period for personal income tax reduction provided to foreign engineers (Article 18 of the Special Tax Treatment Control Law ("STTCL"))

Foreign engineers (a person who provides technology services under an engineering technology license agreement, who works in a R&D facility of a foreign-invested enterprise, or who works in a research institute of a Korean domestic corporation) who started providing services for the first time on or before December 31, 2021 (December 31, 2022 if employed by a leading company specializing in materials, parts or equipment) can access a 50% personal income tax reduction for 5 years (from the date they started providing services). The proposed amendment extends the application period for this personal income tax reduction such that foreign engineers who started providing services for the first time on or before December 31, 2023 can apply the tax reduction.

It is expected that the support provided to businesses attracting talented foreign engineers will be maintained through the extension of the application period for the personal income tax reduction provided to foreign engineers.

(3) Extension of the application period for special tax concession provided to foreigners working in Korea (Article 18-2 of the STTCL)

Under the current law, foreign employees who start to work in Korea for the first time on or before December 31, 2021 can apply a flat personal income tax rate of 19% (in which case other tax exemptions, tax deductions and tax credits are waived) for 5 years from the date they start to work in Korea. Under the proposed amendment, the application period will be extended such that foreign employees who start to work in Korea on or before December 31, 2023 can apply the special flat tax rate.

(4) Extension of the due date for submission of foreign corporations' international transaction documents (Article 130(4) of the Presidential Decree to the Corporate Income Tax Act)

Under the current law, if a foreign corporation's place of business (i.e. permanent establishment) in Korea has transactions with its head office or branches outside Korea, it is required to submit relevant documents such as the internal transaction details and expense allocation calculations by the corporate income tax filing due date. The proposed amendment extends the due date for submission of these documents to 'within 6 months from the last day of the month including the last day of the relevant fiscal year'. The proposed extended due date applies to documents submitted on or after January 1, 2022. This extension is in line with the extension of the due date for Korean domestic corporations' submission of international transaction documents, and is expected to ease the administrative burden for domestic places of business of foreign corporations.

(5) Clarifying the period for filing and requesting refunds based on the arm's length price (Article 6 of the LCITA)

Under the current law, where the price for a transaction between a Korean tax resident and its foreign related party is higher or lower than the arm's length price, the Korean tax resident can file an amendment of the tax base and tax amount or file a tax refund request based on the arm's length price within the relevant period. Going forward, the proposed amendment will introduce a similar "filing after the due date" system for the transfer pricing regime and improve taxpayer convenience by enabling taxpayers to file after the due date.

(6) Simplification of income reporting by the members of an entity that is not a corporation (Article 2 of the PITA)

Under the current PITA, the member of an entity that is not a corporation are each required to file an individual income tax return to the extent (i) the entity has a fixed ratio for distributing profits among its members, or (ii) it can be confirmed that the entity actually distributes profits to its members. Under the proposed amendment, one member of such entity can file a collective income tax return on behalf of the non-resident members if (i) the relevant entity submits the tax information of the non-resident members such as the taxpayer number in the member's country of residence, and (ii) the non-resident members agree to a resident member filing a collective income tax return on behalf of the non-resident members (if only some of the non-resident members agree to such filing, a collective income tax return can be filed just for those members).

The proposed amendment applies to tax returns filed on or after January 1, 2022, and is expected to ease the tax filing burden for the members of an entity that is conducting a business in Korea but is not a corporation.

CONTACT

Yong Whan CHOI
+82-2-528-5709
ywchoi@yulchon.com

Kyu Dong KIM
+82-2-528-5542
kdkim@yulchon.com

Kyung Geun LEE
+82-2-528-5238
kygelee@yulchon.com

Jeremy EVERETT
+82-2-528-5133
jeverett@yulchon.com

Ellie JIN
+82-2-528-5318
elliejin@yulchon.com

Yulchon LLC

Korea | Vietnam | China | Myanmar | Russia | Indonesia*

* in association with Roosdiono & Partners

Subscribe | View More Updates | Contact Us