Korean Tax Update
Samil Commentary

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Tax News

Government Announces Economic Strategy for the Second Half of 2024 and Dynamic Economy Roadmap

On July 3, the government announced its economic strategies for the second half of 2024, along with a comprehensive roadmap aimed at improving the sustainability of the nation's economic growth. The strategy includes a series of tax incentives and regulatory measures designed to stimulate the capital markets, enhance corporate governance and facilitate the implementation of corporate value up programs. The key tax measures proposed include:

- Tax Incentives for corporations disclosing increased shareholder returns ("corporations with greater shareholder returns")
  - A 5% corporate income tax credit for companies that exceed their average shareholder returns (via dividend payouts or cancellation of treasury stock) by, for example, 5% relative to the previous three years
  - Separate taxation of increased dividend amounts received by individual shareholders of those corporations claiming the tax credit above, at lower rates decreased from 14% to 9%, with the maximum rate dropping from 45% to 25%.
- Elimination of the existing premium added in the computation of share values held by the largest shareholders
- Expanded tax deduction for family business succession by corporations with greater shareholder returns:
  - The scope of eligible companies will increase to cover all small and midsize enterprises (SMEs) and middle-scale companies, excluding those companies subject to restrictions on cross-shareholdings. Currently, only SMEs and a limited scope of middle-scale companies with annual sales under KRW 500 billion qualify.
  - Upper tax credit limit will double from KRW 60 billion to KRW 120 billion.
- Increased Support for Individual Savings Accounts (ISAs):
  - The maximum deposit limit per ISA will be raised from KRW 20 million to KRW 40 million per year. The non-taxable deposit cap will increase from KRW 2 million to KRW 5 million per annum, with the limit for ISAs focusing on domestic investment rising from KRW 2 million to KRW 10 million.
  - Cancellation of the scheduled adoption of financial investment income tax

Government Outlines Additional Details of the Semiconductor Ecosystem Support Package with Enhanced and Extended Tax Credits for National Strategic Technologies

The government announced on June 26 a set of measures aimed at bolstering the semiconductor industry's competitiveness. These measures encompass a broad spectrum of financial incentives, tax benefits, and infrastructural support. The latest announcement followed the government's initiative called the 'Semiconductor Ecosystem Support Package,' a KRW 26 trillion plan initially revealed on May 23. The government provided additional details and is set to amend the relevant tax laws, including the Special Tax Treatment Control Law, to facilitate the implementation. A summary of key tax measures proposed is provided below.

- **Extended Tax Credits for National Strategic Technologies:** The sunset clause of the current R&D and investment tax credits for national strategic technologies will be extended until the end of 2027, a three-year extension from the original expiration date in 2024. Furthermore, the scope of national strategic technologies eligible for these credits will be broadened to include specific raw materials, components, and equipment integral to the production of advanced semiconductors. This expansion will be subject to the assessment of an expert advisory group.

- **Broadened R&D Tax Credit Scope:** The eligible expenses for R&D tax credits for strategic technologies will include costs incurred to acquire or lease the software that is utilized exclusively for R&D purposes. This excludes software used for support, general office administration, or operational systems. Additional eligible expenses will be rental and usage fees for research and testing facilities, remuneration for employee inventions, and fees for technical information and consultancy services.

  For research staff engaged in R&D activities for national strategic technologies as well as other general R&D activities, the tax credit rate for national strategic technology R&D will be applied based on actual research time dedicated to the relevant R&D activities, provided that the majority of research time is devoted to national strategic technology R&D. This approach based on the pro rata ratio of the time spent for national strategic technology R&D is a shift from the current practice, which simply applies a general R&D tax credit rate, regardless of the time incurred for national strategic technology R&D.

- **Accelerated Depreciation for R&D Assets:** The depreciation period for R&D facilities will be reduced from five years to three years, aligning with the useful life typically applied to testing and measurement equipment.

Government's Strategy for Supply Chain Stabilization and Integration of Key Technologies into National Strategic Technologies, Etc. Eligible for Tax Incentives

Following the enactment of the Basic Law on Supply Chain Stabilization Support for Economic Security (referred to as the "Basic Supply Chain Law") in June 2024, the inaugural meeting of the Supply Chain Stabilization Committee was held on June 27. The committee unveiled a comprehensive strategy to stabilize the supply chain that would increase financial and tax incentives for the domestic development of technologies critical to supply chain stability. Additionally, it proposes easing the criteria for tax credits related to investments aimed at securing and brining essential overseas mineral resources into the country.

The key tax measures proposed are:

- Incorporating technologies critical to supply chain stability into the scope of new growth, core and national strategic technologies which are eligible for R&D and investment tax credits, thereby further encouraging R&D activities for the domestic development of such technologies.
- Modifying the existing tax credit for investments in overseas natural resources obtained via a foreign subsidiary. The modification will relax the ownership requirement for domestic corporations to qualify for investment tax credit, which allows a 3% credit of the investment amount against the corporation's income tax liability. To qualify for this credit, a domestic corporation must currently make a 100% investment in the foreign subsidiary.
- Introducing customs benefits for domestic corporations that repatriate resources produced from their overseas resource development projects into Korea.

Additional Tax Incentives Proposed with the Designation of Special Opportunity Development Zones in 20 Areas across Eight Cities and Provinces

The Presidential Council on New Initiative for Regional Development has officially designated 20 areas as special opportunity development zones across eight major cities and provinces, such as Gyeongsangbuk-do and Daegu. This decision, made during the council's meeting on June 20, marks the first designations made out of applications submitted by April 2024. Over 200 corporations are poised to invest approximately KRW 26 trillion in these zones, according to the data compiled by the government. These designated zones will receive additional incentives beyond the existing fiscal and tax benefits. As part of the additional incentives, the government plans to ease the criteria for inheritance tax deductions for family businesses relocating to these zones and to increase the maximum deduction limit for qualifying successions.

Moreover, the government is dedicated to creating a conducive environment for the growth of SMEs as well as middle-scale companies within these zones. These businesses will be eligible for preferential treatment, such as government subsidies designed to boost regional investment.

Currently, companies that commence operations or establish new business places in these zones are entitled to a 100% exemption from individual or corporate income tax on taxable income for the initial five years, and a 50% reduction for the following two years.

Proposed Tax Measures to Help Reverse a Falling Birth Rate

The Presidential Committee on Low Birth Rate and Aging Society in Korea has unveiled a comprehensive set of fiscal and tax initiatives designed to reverse the nation's falling birth rates. These initiatives include three main areas of focus: 1) balance between work and family life; 2) education and childcare support; and 3) incentives for housing, marriage, childbirth and childcare. Under the proposed tax measures, couples acquiring a second home upon marriage will be treated as single homeowners for the purposes of capital gains tax and comprehensive real estate holding tax for 10 years, a five-year extension from the current five years. The measures also include increases in child tax credits. Specifically, the amount of tax credit will increase from KRW 150,000 to KRW 250,000 per year for the first child while it will increase for the second child from KRW 200,000 to KRW 300,000 per year, and for the third from KRW 300,000 to KRW 400,000 per year. Additionally, special corporate contributions for employees who give birth will be exempt from taxation.

NTS has Notified Reporting Deadline for Deemed Gift Taxation of Profits from Certain Related Party Transactions

The National Tax Service (NTS) has informed that a person, who is subject to deemed gift taxation on profits derived by a domestic corporation with a fiscal year ending December 31 from certain related party transactions, must file a gift tax return and pay any gift tax by July 31, 2024.[1)] Those who are obliged to report are the ‘controlling shareholder and his/her relatives’ (“the controlling shareholder”) of the domestic corporation (beneficiary corporation) which obtains business opportunities from a related party of the controlling shareholder and whose revenue from the related party exceeds a certain percentage of the corporation’s total sales revenue for FY2023. The failure to file or pay gift tax by the due date will be subject to a 20% non-reporting penalty and a late payment penalty of 0.022% per day. The NTS will perform the post-filing verification to ensure accuracy and compliance with the reporting requirements.

Note 1): The gift tax return filing and payment is due by three months from the end of the month in which the beneficiary corporation's corporate tax filing due date falls. Corporations with a fiscal year ending on December 31 are required to file and pay corporate taxes by March 31, and thus, the related gift tax due date is June 30. For FY2023, the corporate tax return due date has been extended to April 1, 2024, which results in the gift tax return due date on July 31, 2024.

Changes in Tax Laws

Amended Presidential Decree of the Comprehensive Real Estate Holding Tax Law

Background of Amendment

The tax base for the comprehensive real estate holding tax on residential properties is calculated by aggregating the announced standard prices of taxable properties, after applying certain deductions and multiplying by the fair market ratio as prescribed by law. The amended decree provides an exception to the taxable properties subject to the comprehensive real estate holding tax, which temporarily excludes unsold new housing located outside Seoul metropolitan areas, acquired by corporate restructuring real property investment companies. This measure aims to facilitate the recovery of the struggling construction markets and boost demand for unsold new houses. This temporary exception will remain in effect from March 28, 2024 through December 31, 2025.

Amended Presidential Decree of the Individual Consumption Tax Law

Background of Amendment and Key Points

To alleviate the public burden from high oil prices, the amended Presidential Decree extends the temporary reduction in the individual consumption tax rate for butane among liquefied petroleum gas products by an additional two months until August 31, 2024. The reduction in tax rate is adjusted to KRW 193 per kilogram due to a recent downturn in oil prices. Additionally, to ease the burden of power generation costs, the decree extends the temporary reduction in individual consumption tax on natural gas for power generation and bituminous coal by an additional six months, effective through December 31, 2024. (Proclaimed and enforced on June 28, 2024)

Amended Presidential Decree of the Transport, Energy and Environment Tax Law

Background of Amendment and Key Points

To alleviate the public burden from high oil prices, the amended Presidential Decree extends the temporary reduction in flexible tax rates for gasoline, diesel, and similar alternative fuels by an additional two months until August 31, 2024. In light of the recent decline in oil prices, the tax rate reduction for gasoline and similar alternative fuels has been adjusted to KRW 423 per liter, while the reduction for diesel and similar alternative fuels has been set at KRW 263 per liter. (Proclaimed and enforced on June 28, 2024)

Amended Rules for the Application of a Tariff-rate Quota under Article 71 of the Customs Law

Background of Amendment and Key Points

Under Article 71 (1) of the Customs Law, where it is necessary to promote imports for the purpose of ensuring the smooth supply of goods or strengthening competitiveness of industries, or to stabilize domestic prices of goods whose import prices have surged, tariff rates lower than the basic rate may be applied to certain quantities of goods under the quota system. To alleviate the impact of international energy price hikes in the domestic markets, the latest amendment continues to apply tariff rates on naphtha, crude oil used to manufacture liquefied petroleum gas (LPG), as well as natural gas and LPG through the end of December 2024. This represents a six-month extension from the previous deadline of June 2024. Additionally, to stabilize the prices of daily necessities, the amended rules adjust the items subject to tariff rates and the applicable rates as follows: i) the tariff rate on sugar is lowered from 5% to 0%; ii) the application of tariff rates to 27 kinds of imported goods, including egg processed foods, crude spirits and frozen strawberries, is extended by six months through the end of December 2024; and iii) tariff rates ranging from 0% to 10% apply to seven imported goods, including orange concentrate, coffee concentrate and whole milk powder, from July 1 through December 31, 2024. (*Proclaimed and enforced on June 28, 2024*)

Rulings Update

Tax treatment of profits distributed by individual shareholders to their related parties through unfair capital transactions

Where a domestic corporation distributes profits to its related parties through certain types of unfair mergers, capital increases, capital reductions, and other unfair capital transactions ("unfair capital transactions"), as specified in the Presidential Decree of the Corporate Income Tax Law (CITL, Article 88 (1)(8) and (8-2)), the provision of the CITL on the denial of unfair transactions between domestic related parties shall be applied. Also, where a domestic corporation receives profits from its related parties through unfair capital transactions, the profits shall be included in the gross income of the corporation according to Article 11(8) of the Presidential Decree of the CITL ('provision at issue'). This case concerns whether profits received by a domestic corporate shareholder from another individual shareholder in the domestic company through capital transactions prescribed in Article 88(1)(8-2) should be included in the gross income of the domestic corporate shareholder under the provision at issue. In other words, it addresses the issue whether the scope of related parties in the provision at issue encompasses not only corporate shareholders but individual shareholders in domestic companies.

In this regard, the Supreme Court ruled that the scope of related parties under the provision at issue should include individual shareholders, in addition to corporate shareholders. The court reasoned that: i) the provision at issue does not limit the profit distributor to a corporate shareholder; ii) the amendment to the provision at issue on December 29, 2000 only added types of capital transactions, and as such, it appears that the provision aims to clarify that the profit distributed by an individual shareholder is also included in gross income; and iii) the provision at issue aims to tax the profit distributed by a related party through unfair capital transactions, regardless of whether the profit distributor is a corporate shareholder or an individual shareholder (*Daebeop2023du39809, 2024.6.13*). The Supreme Court reversed and remanded the lower court's decision, which ruled that the provision at issue can only be applied to profits distributed by a corporate shareholder and profits distributed by an individual shareholder do not constitute gross income of the recipient (*Seoul High Court 2002nu53299,2023.3.21*).

Observation: Previously, the Supreme Court has affirmed the lower court's decision that profits distributed not only by corporate shareholders but also by individual shareholders constitute the gross income in a similar case through a dismissal without an explicit judgment. However, as the lower court in this case ruled that the profits distributed by individual shareholders did not constitute gross income, the issue of whether the profits distributed by individual shareholders would constitute gross income has been resurfaced. Regarding this, the Supreme Court has explicitly ruled that the profits distributed by individual shareholders should be also subject to the provision at issue, thereby resolving the controversy surrounding this issue. Additionally, this decision is anticipated to be applied consistently to cases involving other types of unfair capital transactions

outlined under Article 88 (1) (8-2) of the Presidential Decree of the CITL as well as those under Article 88(1)(8) of the Presidential Decree. Accordingly, where a person distributing profits through unfair capital transactions is a related party of the domestic company receiving the profits, such distributed profits may constitute the gross income of the domestic company for corporate income tax purposes, irrespective of whether the person is an individual or a corporate shareholder, based on the Supreme Court's decision. This needs to be considered when reviewing the tax implications of unfair capital transactions.

Whether the corporate income tax on corporate earnings reserve is deductible in calculating deemed gift profits from certain related party transactions

Under Article 45-3 of the Inheritance and Gift Tax Law (IGTL), a liability to deemed gift tax arises where the ratio of a domestic corporation's sales to a company, which is a related party of its controlling shareholder and their relatives, to its annual sales for a taxable year exceeds the prescribed ratio in the IGTL ('beneficiary corporation'). The 'deemed gift' profits of the beneficiary corporation are calculated from its after-tax operating profits, as prescribed in Articles 34-3(10), 34-4(4), and 34-5(4) of the Presidential Decree of the IGTL ('provisions at issue'). A key issue is whether the corporate income tax on the corporate earnings reserve ('CIT on CER') of the beneficiary corporation should be included in the scope of the corporate income tax to be deducted under the provisions at issue in calculating the corporation's after-tax operating profits.

The NTS has issued an authoritative interpretation that the CIT on CER should be included in the scope of the corporate income tax to be deducted in calculating the after-tax operating profits of the beneficiary corporation. The related Presidential Decree of the IGTL provides that the corporate income tax under the provisions at issue shall refer to the beneficiary corporation's corporate income tax calculated on according to Article 55 of the CITL (comprised of the annual corporate income tax, the CIT on CER and corporate tax on capital gains from the sale of land, etc.), but specifically excludes the corporate tax on capital gains arising from the sale of land, etc. therefrom, for a relevant tax year. The NTS further clarified that it would be reasonable to interpret that the CIT on CER should be included in the scope of the corporate income tax to be deducted in calculating the after-tax operating profits based on the relevant provisions of the Presidential Decree above. The rationale of this interpretation seems to include that: i) the deemed gift tax provisions target the beneficiary corporation's after-tax operating profits; and ii) similarly, the CIT on CER is also based on the taxable income of the beneficiary corporation for a taxable year, and as such, it is appropriate to deduct the CIT on CER in calculating the beneficiary corporation's after-tax operating profits for deemed gift taxation purposes. (*Gijoon-2023-Beobgyujaesan-0125, 2024.5.13*)

Observation: The recent NTS interpretation indicates that the inclusion of CIT on CER consistently applies to the calculation of not only profits derived from related party transactions prescribed in Article 45-3 of the IGTL but those derived from business opportunities provided by related parties (Article 45-4) or transactions with specific controlled corporations (Article 45-5) under other deemed gift taxation provisions of the IGTL. To ensure the accurate gift tax compliance in accordance with the IGTL, it is imperative to include the CIT on CER, as well as the corporate

income tax, for the relevant fiscal year in the scope of the corporate income tax to be deducted in calculating gift taxes under the relevant deemed gift taxation provisions of the IGTL.

Clarification on the application of full-time employee status for fixed-term employees with renewed contracts in applying the tax credit for employment increase

The Special Tax Treatment Control Law (STTCL) provides for a tax credit for companies that increase their number of full-time employees compared to the previous year, as prescribed in Article 29-7. For the purpose of this tax credit, 'fixed-term employees' who have employment contracts for less than one year are not considered full-time employees. However, where the employment contract period of fixed-term employees exceeds one year through consecutive renewals of their employment contracts, such employees are classified as full-time employees in accordance with Articles 26-7(2) and 23(10)(1) of the Presidential Decree of the STTCL. The issue in this case is whether a fixed-term employee with an initial employment contract period of less than one year, who becomes a full-time employee due to consecutive renewals of the contract totaling more than one year, would be considered as a full-time employee from the initial fixed-term employment contract period or from the renewed contract period for the application of tax credit for employment increase.

In this regard, the Ministry of Economy and Finance (MOEF) issued an authoritative interpretation, clarifying that the current regulations have no explicit provision specifying a precise point at which a fixed-term employee becomes a full-time employee due to consecutive renewals of an employment contracts. Nonetheless, for the purpose of applying the tax credit for increasing employment, the number of full-time employees is counted at the end of each month in the relevant tax year, as stipulated by Article 26-7(7) of the Presidential Decree of the STTCL. Consequently, employees with a total duration of employment exceeding one year through consecutive contract renewals, are considered full-time from the month in which the contract exceeding the one-year threshold becomes effective. (*MOEF, Tax Relief Policy Division-511, 2024. 6. 19.*).

Observation: In assessing a company's eligibility for the tax credit for employment increase (Article 29-7 of the STTCL), the integrated employment-related tax credits (Article 29-8 of the STTCL), and the social security tax credit for SMEs (Article 30-4 of the STTCL), it should be carefully considered that changes in the number of full-time employees should be determined not retroactively from the initial employment contract period of a fixed-term employee, but from the renewed contract period that extends to one year or more.

Clarification on the retroactive application of extended special tax concessions for earned income of foreign workers prior to tax law amendments

Article 18-2 of the STTCL provides that foreign workers in Korea have the option to be taxed at a flat rate of 19% on their employment income (instead of a progressive income tax rate with the highest marginal tax rate) until the tax period ending within 20 years from the first date on which they provided employment services in Korea. This 20-year period eligible for the special tax concession is based on the amendment to the STTCL in December 2022, which was expanded from the previous 5 years to 20 years in order to encourage the influx of outstanding foreign talent into Korea. The supplementary provisions of the amended STTCL (*Addenda 10 of the STTCL, amended on December 31, 2022*) clarify that the extended 20-year period also applies to foreign workers who have not exceeded 20 years from the date they first provided employment services in Korea as of January 1, 2023. The pertinent issue arises for foreign workers who began their employment in Korea before December 31, 2022, and for whom the 20-year period had not elapsed by January 1, 2023. The issue in this case is whether the special tax concession can be retroactively applied to income earned by such foreign workers before December 31, 2022 in line with the supplementary provisions of the amendment.

The Tax Tribunal's decision indicates that the special tax concession under the amended law is applicable to foreign workers who have not exceeded 20 years of employment in Korea as of January 1, 2023, in line with the supplementary provisions. However, the decision also clarifies that it is not appropriate to allow the retroactive application of the 20-year tax concession to income earned before December 31, 2022 as it is explicitly stated to apply the amended law from January 1, 2023 under Article 1 of the supplementary provisions of the STTCL amended on December 31, 2022. (*Joshim2023seo10372, 2024.4.30*)

Observation: The decision specifies that the supplementary provisions allow the extended 20-year special tax concession to be applied prospectively to income earned by foreign workers after January 1, 2023. This concession is not retroactively applicable to income earned before the amendment of the STTCL on December 31, 2022. The decision further interprets the 'first date on which a foreign worker provides employment services in Korea', which is the start date for the 20-year special tax concession period, in the following manner: i) in case of foreign workers who were employed in Korea before 2013 and re-entered into Korea to resume work on or after January 1, 2014, the resumption date is considered the start date; and ii) in case of foreign workers employed as of January 1, 2014, the start date is January 1, 2014. (*MOEF, Individual Taxation Policy Division-135, 2023.2.21, Advance Ruling-2023-Beobgyugukjo-0624, 2023.11.17*)

The content is for general information intended to facilitate understanding of recent court cases and authoritative interpretations. It cannot be used as a substitute for specific advice and you should consult with a tax specialist for specific case.

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