Korean Tax Update

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Tax News

Government to Establish a Growth Ladder for SMEs, Extending the Grace Period for Graduating SMEs to Seven Years

The government announced on June 3, 2024 its comprehensive plan to support the growth of small and midsize enterprises (SMEs) as a method to establish a ladder for growth. This plan aims to provide support for SMEs transitioning to middle-scale companies through extended tax incentives, etc. In order to implement these support measures, the government will take steps to amend the Special Tax Treatment Control Law and the related Presidential Decree during the second half of 2024. The tax benefits contained in the comprehensive plan include:

- Extending the grace period for companies, which came to exceed the criterion of SME in scale, from three years to five years. During the grace period, the companies which no longer qualify as SMEs can continue to benefit from various tax concessions available under the Special Tax Treatment Control Law including preferential rates of investment tax credit, R&D tax credit, and employment-related tax credit.
- Further extending the grace period for companies, which no longer satisfy the SME criterion and are listed on the Korea Exchange and the KOSDAQ, by two additional years, resulting in a seven year grace period for these companies.
- Introducing preferential rates of R&D tax credits and investment tax credits during an additional three year period after the transition to middle-scale companies following the grace period.

Government Unveils Measures to Support the Semiconductor Ecosystem with a Tax Credit Extension for National Strategic Technology

The government has recently announced a comprehensive plan to strengthen the competitiveness of domestic companies in the global semiconductor markets. The initiative, called the "Semiconductor Ecosystem Support Package," is valued at KRW 26 trillion, with a KRW 18.1 trillion semiconductor financial support program set to be implemented this year. To expedite the building of semiconductor mega clusters, the government will provide reinforced support for the construction of infrastructure, including roads, water supply and electricity. In addition, the plan includes increased funding for research and development (R&D) and workforce development. To incentivize growth, the plan incorporates tax relief measures that would extend the existing tax credits for national strategic technologies and allow companies to claim tax credits for the purchase of semiconductor design software and other related expenditure. The government also plans to shorten the depreciation period for R&D facilities and expand the scope of national strategic technologies in the semiconductor field, ensuring that all essential technologies can be eligible for related tax breaks.

NTS Requires Reporting of Foreign Financial Accounts with More Than KRW 500 million by July 1

The National Tax Service (NTS) informed that residents and domestic corporations must report their foreign financial accounts to relevant tax offices from June 1 to July 1, 2024 (as June 30, 2024 is a weekend) if the balances exceed KRW 500 million as at any month-end in the calendar year 2023. Beginning from 2023 in particular, the foreign financial accounts subject to the reporting requirements include overseas virtual asset accounts that were opened with overseas virtual asset service providers for the trading of virtual or similar assets, as defined by the Law on Reporting and Using Specified Financial Transaction Information. To assist the reporting process for holders of overseas virtual assets, the NTS has consulted with domestic virtual asset service providers to provide guidance on the foreign financial account reporting system. The NTS will conduct post-filing verification, relying on data obtained through inter-governmental agreements for exchanges of financial information, as well as data collected by other institutions such as the Financial Intelligence Unit. Failure to comply with the reporting obligation may result in penalties of up to 20% of the unreported or underreported amount, with a maximum cap of KRW 2 billion. Furthermore, if the unreported or underreported amount exceeds KRW 5 billion, the taxpayer may be subject to criminal punishment, and a list of non-compliant individuals may be disclosed.

Comprehensive Real Estate Holding Tax for 2023 Marks a Significant Decline of 37.6%, Amounting to KRW 4.2 trillion

The NTS has recently released the statistics on the comprehensive real estate holding tax for the year 2023. The data indicates that in 2023, the total number of taxpayers stood at 495,000, marking a significant decline of 61.4% (or 788,000 taxpayers) compared to 2022. Additionally, the final tax liabilities for the year totaled KRW 4.2 trillion, recording a decline of 37.6% (or KRW 2.5 trillion) from the previous year. The NTS attributes these declines to various factors, including decreases in the announced standard real estate prices, increased basic deductions and decreased tax rates for housing. With comprehensive real estate holding taxation specifically focusing on housing (excluding land), there was a significant decline both in the number of taxpayers and final tax liabilities. In 2023, the number of taxpayers totaled 408,000, reflecting a 65.8% decline from the 1,195,000 taxpayers in 2022. Furthermore, the final tax liabilities for housing decreased by 71.2%, amounting to KRW 900 billion compared with KRW 3.3 trillion in 2022. In contrast, there were no significant changes observed in the comprehensive real estate holding tax on land subject to general aggregate taxation, as well as land subject to special aggregate taxation, in terms of the number of taxpayers and final tax liabilities during this period. It is noteworthy that the top 10% of taxpayers accounted for a significant portion of the total amount of final comprehensive real estate holding tax liabilities, representing 88.5% (KRW 3.7 trillion) of the total final tax liabilities.

Changes in Tax Laws

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 address shortages of agriculture and fish product supplies and to stabilize the prices of living necessaries, the latest amendment applies the 0% and 5% tariff rate to imported cabbages and grapes, respectively, effective from May 10 through June 30, 2024. Furthermore, the amended rules apply the 0% tariff rate to four additional types of imported products, such as carrots and dried seaweeds (from May 10 through September 30, 2024), Kimchi cabbages (from May 10 through October 31, 2024) and cocoa beans (from May 10 through December 31, 2024). (*Proclaimed and enforced on May 9, 2024*)

Amended Presidential Decree of the Local Tax Law

Background of Amendment

The Local Tax Law (LTL) has been amended to introduce an upper limit on the property tax base for residential properties. The amendment also eliminates the scheme that limited the rate of increase of property tax liabilities to a certain percentage of the previous year's tax amount. The amended Presidential Decree provides detailed guidelines for computing this upper limit, in line with the amended LTL. Furthermore, the amended decree improves the criteria for applying higher acquisition tax rates to CR REITs (corporate restructuring real estate investment trusts) purchasing unsold new apartment units, with a view to facilitating the recovery of the sluggish construction sector. Additionally, the amended decree allows the land attached to demolished vacant houses to be eligible for special aggregate taxation if the land is used for public or common purposes. This provision aims to reduce the property tax burden on taxpayers. Moreover, it expands the scope of houses that are not counted when determining the number of houses and eligibility for property tax reliefs available for families owning only one house. This expansion is intended to help increase or maintain the residential population in regions suffering from a decline in population. *(Proclaimed and enforced on May 28, 2024)*

Key Points

Improved taxation for the acquisition of unsold apartment units by CR REITs: Effective from March 28, 2024 through December 31, 2025, where a CR REIT acquires unsold new apartment units in a non-metropolitan area by transfer for consideration, the CR REIT is not subject to a higher acquisition tax rate in relation to the acquisition of the unsold apartment units.

Expanded eligibility for special aggregate taxation: The land attached to demolished vacant houses will be classified as eligible for special aggregate taxation if the land is used for public or common purposes by the state, a local government, or an association of local governments for at least one year.

Specific standard for computing the upper limit of property tax base: The amount of the previous year's tax base, which is used to determine the upper limit of the property tax base, will be calculated based on the announced standard price of a house, multiplied by the fair market price ratio as of the base date for taxation. The upper limit will be set at 5% of this calculated value.

Special tax treatment for acquisitions in depopulation areas: A special property tax treatment is applied to a family owning only one house, with certain properties not included in determining the number of houses held by the family. The properties not included in the computation shall meet the following conditions: the property shall be situated in an area losing population; it shall not be located in the same administrative area (S*i, Gun, Gu*) where the existing house owned by the family is located; and the announced standard price of the property shall be KRW 400 million or less. This special tax treatment shall apply to houses acquired by transfer for consideration or original acquisition made between January 1, 2024, and December 31, 2026.

Amended Presidential Decree of the Law for Liquor Licensing, etc.

Background of Amendment and Key Points

According to the recent amendments to the Law for Liquor Licensing, etc., simple processing or manipulation of alcoholic beverages would not be regarded as a reason for canceling liquor sales licenses. Under the amended law, dividing alcoholic beverages into smaller portions upon the request from consumers will no longer lead to a license cancellation. The amended Presidential Decree of the law clarifies that simple processing or manipulation includes selling liquor in small portions using empty containers, and selling liquor by mixing it with carbonated drinks or fruits on the spot. To improve the distribution structure of non-alcoholic beverages and those with little alcoholic content for adult use, the amended Presidential Decree allows wholesale liquor distributors to deal in these products as well. *(Proclaimed and enforced on May 28, 2024)*

Amended Enforcement Rules of the Local Tax Law

Background of Enactment and Key Points

As per the recent amendments to the LTL and the related Presidential Decree, an upper limit has been introduced for the property tax base, and certain houses acquired in depopulation areas are not included when determining the number of houses held by a family to decide the eligibility for special property tax treatment applicable to a family owning only one house. To provide further details, the amended Enforcement Rules of the LTL require that the guidelines on the upper limit of the property tax base are included on the blank form of property tax payment notice on housing. Additionally, taxpayers are allowed to indicate houses acquired in areas losing population on the application form to request the houses indicated are not counted in the number of houses considered in determining eligibility for property tax relief. Furthermore, the amended enforcement rules update the property tax filing returns to allow information about trustees of trusted properties to be included. (*Ordinance of the Ministry of the Interior and Safety No. 485, Proclaimed and enforced on May 28, 2024*)

Rulings Update

Whether sales discounts offered to employees of a company's affiliated or partner companies would be treated as the company's entertainment expenses

In this case, a company carrying out a wholesale and retail business offered goods to employees of its affiliated and partner companies at a 40%/50% discounted price, lower than the final consumer price ('sales discount in question'). The main issue is whether the sales discount in question should be considered as deductible 'sales-related expenses' incurred in the course of performing the company's ordinary business activities and marketing strategies to increase its sales revenue, or as 'entertainment expenses' incurred for the purpose of facilitating its business relationship with specific affiliated and partner companies by offering discounted prices to their employees, which are subject to a deduction limit for tax purposes.

The Tax Tribunal carefully considered the following factors when reaching its decision that the sales discount in question should be classified as entertainment expenses incurred by the company to facilitate business relationships with companies directly or indirectly related to its operations: 1) the recipients of the sales discount in question are the employees of its affiliated and partner companies that are directly or indirectly related to the manufacturing, distribution and sales of the company's products; 2) there is no clear evidence of any contractual or legal rights and obligations for the company to provide the sales discount in question to the employees of its affiliated or partner companies; 3) if the purpose of offering the sales discounts is to boost the company's sales revenue (as per the company's argument), there is no logical basis for limiting the beneficiaries of sales discounts solely to the employees of the affiliated and partner companies; and 4) the sales discounts in question apply to new products that are currently sold to consumers at regular prices on the retail stores, and the discount rates of 40%/50% offered to a specified and limited number of employees are relatively high, suggesting that the sales discount in question cannot be seen as an ordinary sales promotion or marketing initiative. (*Joshim2023seo9469, 2024. 3. 29*.).

Observation: In this case, the company argued that the sales discount in question was offered pursuant to its ordinary marketing strategies aimed at generating operating profits. However, the Tribunal pointed out that if the sales discount in question were a marketing strategy to increase the company's sales revenue, it should have been extended beyond the employees of affiliated and partner companies to include other consumers having no business relationship. The Tribunal also emphasized that the discounted items included new products that are typically sold to consumers in the stores. Taking these factors into consideration, the Tribunal treated the amount of sale discount in question as entertainment expenses for tax purposes. It is worth noting that where companies offer high-rate sales discounts on products, including new products, to a specified and limited number of people such as employees of affiliated or partner companies, it should be aware that the sales discount may be considered entertainment expenses, subject to a deduction limit, for tax purposes.

Whether bad debt expenses written off by a SME on the books would be deductible when the statute of limitations for the related receivable had expired

Under the Corporate Income Tax Law (CITL), where an SME writes off accounts receivables or other receivables (excluding receivables from transactions with related parties, hereinafter referred to as 'the receivables') as bad debts on its books, for which at least two years have passed from the payment due dates, the SME may claim a deduction of bad debts for tax purposes in the fiscal year when the receivables are written off on its books (*Article 19-2(1)(9-2) and (3)(2) of the Presidential Decree of the CITL*, hereinafter referred to as 'the provision in question'). A recent decision by the Tax Tribunal deals with the case where the receivables incurred prior to 2013 were written off as bad debts on the SME's books in 2020 after the statute of limitations for the receivables expired and thus the legal right to claim the receivables was already extinguished (hereinafter referred to as 'the receivables in question'). The issue in this case is whether the bad debt expenses from the write-off of the receivables in question would be deductible for tax purposes in the fiscal year when the receivables were written off on the SME's books based on the provision in question, or whether they would not be deductible considering the statute of limitations for the receivable had expired.

Regarding this, the recent Tribunal decision states that the provision in question cannot be applied to the receivables in question because the statute of limitations for the receivables had expired before the year of write-off. Essentially, the provision in question, although it is aimed at easing the tax burden on SMEs suffering from bad debts, would be only applicable to overdue receivables for at least two years after the payment due date, provided that the legal rights to claim the receivables still exist. This indicates that the provision in question cannot be extended to cover the receivables with extinguished legal claims as the statute of limitations has already expired (*Joshim2024seo0368, 2024. 4. 25.*).

Observation: Under the CITL, bad debt expenses can be classified into the following two categories for tax deduction purposes: (i) 'bad debt expenses made through tax adjustments on the income tax returns' (*Article 19-2(3)(1) of the Presidential Decree of the CITL*) and (ii) 'bad debt expenses made from the write-offs of receivables on the books' (*Article 19-2(3)(2) of the Presidential Decree of the CITL*). The former allows a company to deduct bad debt expenses on its income tax return in the fiscal year when one of the prescribed reasons, such as the expiration of the statute of limitations for receivables, took place and thus its legal claims on the receivables were extinguished, irrespective of whether they were written off on the company's books. The latter allows a company to deduct bad debt expenses when the receivables are actually written off on the books for one of the prescribed reasons such as the debtor's bankruptcy even though the legal claims on the receivables have not been extinguished. (*Article 19-2(1) and (3) of the Presidential Decree of the CITL*). In the latter case, the company may take an early deduction of bad debt expenses in the year of write-off on the books for the receivables with valid legal claims before the year in which the statute of limitations expires. Given that the provision in question falls under the latter case, the Tribunal decision that a deduction of bad debt expenses for tax purposes under the provision in question can only be applied to receivables with valid legal claims also appears to be reasonable in a legal context. Therefore, where an SME writes off long-aged receivables for at least two years after the payment due date on its books but the statute of limitations has expired before the year of write-off, it would be crucial to review whether a deduction of bad debts can be claimed through the filing of the amended income tax return for tax refund request for the prior year which the expiration date of the statute of limitations for the receivables belong to (rather than the current year when the bad debt expenses are recorded on the books).

Whether the number of full-time employees would include employees on maternity leave in applying a tax credit for employees returning from childcare leave

The tax law provides that a certain percentage of labor costs paid by SMEs or middle-scale companies for their employees returning from childcare leave by December 31, 2022 can be credited from corporate income taxes for a fiscal year and the following year (i.e. until December 31, 2023). To qualify for this tax credit, the number of full-time employees for the concerned year must be maintained at the same level as that for the previous year (*Article 29-3(2) of the Special Tax Treatment Control Law*). This authoritative interpretation addresses the question of whether an employee on maternity leave can be included in the number of full-time employees, where a replacement worker is hired by the SME, and the SME pays social security taxes for both the employee on maternity leave and the replacement worker, in determining whether the SME meets the requirement for the maintenance of the number of the full-time employees for the tax credit for employees returning from childcare leave.

Regarding this matter, the authoritative interpretation states that in order to apply for the tax credit for employees returning from childcare leave until December 31, 2023, employees on maternity leave should be included in the number of full-time employees unless the employees on maternity leave are considered disqualified full-time employees prescribed in the law. Disqualified full-time employees refer to those individuals on maternity leave for whom there is no evidence of income tax withholding or payment of national health insurance premiums. (*Tax Relief Division of the MOEF-366, 2024. 5. 3.*) Instead, the interpretation affirms that the employees on maternity leave should not be excluded from the number of full-time employees, as they are considered to be continuously "employed" due to their employment relationship with the employer, even though they are not classified as full-time employees during the maternity leave period. It is considered a reasonable interpretation that aligns with the authoritative interpretation under the Labor Standards Act. (*Labor Standards Policy Division of the Ministry of Employment and Labor -4508, 2021. 12. 24.*).

Observation: This authoritative interpretation includes employees on maternity leave in the number of full-time employees in applying the provision for tax credits for employees returning from childcare leave. This interpretation is expected to remain in effect for the tax credit for increasing employment (as specified in Article 29-7 of the STTCL) and for the provision of additional corporate income tax on excess corporate earning reserves (*as specified in Article 100-32 of the STTCL*). However, it should also be noted that a recent amendment to the law (*Article 28-8(7) of the Presidential Decree of the STTCL, amended on February 29, 2024*) specifically excludes replacement workers from the number of full-time employees in applying tax credits for the conversion of irregular workers to regular workers and for the employees returning from childcare leave under the provisions for the integrated employment-related tax credits (*Article 29-8 (3) and (4) of the STTCL*). This amendment aims to stabilize the employment by eliminating temporary fluctuations in the number of employees. Therefore, companies using replacement workers to cover employees on maternity leave should exclude the replacement workers from the number of full-time employees in applying tax credits for conversion to regular workers and for employees returning from childcare leave under the amended provisions for the integrated employment-related tax credits. These amended provisions contradict the recent authoritative interpretation.

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