Korean Tax Update

Samil Commentary

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2021 Edition of the Medium and Long-term Direction of the Government's Tax Policy

The Ministry of Economy and Finance (MOEF) announced the 2021 edition of the medium and long-term direction of the government's tax policy and administration that has been outlined in a recent meeting of the Medium and Long-Term Tax Policy Review Committee on May 26. Currently, the Basic National Tax Law requires the Ministry to prepare a five-year plan for tax policies and administration every year to enhance the efficiency of tax system and the equity of tax burden. The latest edition of medium and long-term direction for the tax policy and system focuses on the following three objectives:

- Secure growth momentum by expanding support for the growth of core industries including semiconductors
- Focus policy capacity on improving inclusiveness so that the bipolarization deepened since the outbreak of the COVID-19 pandemic would not be cemented
- Streamline tax exemption, reduction or non-taxation schemes and realign taxation frameworks to address tax evasions and fraud

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Tax Incentives to Stimulate R&D and Facility Investment in Strategic Core Technologies including Semiconductors

The MOEF has revealed the government's plan to expand tax incentives to spur research and development (R&D) and facility investment in semiconductors and certain strategic core technologies. As part of the plan, the Ministry will submit a draft bill to amend the Special Tax Treatment Control Law (STTCL) to the National Assembly in September. If approved, expanded incentives included in the draft bill will apply to investments made in the second half of 2021 onward, thereby supporting preemptive corporate investments with tax incentive measures.

The STTCL currently allows companies to claim tax credits for qualifying R&D expenditure (R&D tax credit) and for qualifying investment in specified industries (investment tax credit). Under the current two-tiered structure, different tax credit rates apply depending on the category of technology, that is general vs. new growth-engine· source technology. The draft bill will add a third category of strategic core technology to allow higher rates of R&D and investment tax credits. The proposed expansion of tax incentives for R&D activities and facility investment for the development of strategic core technologies is aimed at securing core semiconductor technologies and accelerating expansion of mass production facilities. The specific scope of strategic core technologies will be decided in light of several elements, such as the need to occupy preferentially and sustain national competitive advantages in the global market as well as the importance for the national economy.

Korea Signs a Free Trade Agreement with Israel

The Ministry of Trade, Industry and Energy announced that Korea and Israel signed a free trade agreement (FTA) in Seoul on May 12. Among other things, the FTA will:

- achieve a trade liberalization at a high level where Korea and Israel will abolish 95.2% and 95.1% of commodity tariffs, respectively;
- introduce a negative-list type for treatment of services and investment to ensure a mutual commitment to market opening at a level not less than that of the General Agreement on Trade in Services (GATS) of the WTO, while offering the most favored nation and national treatment in terms of investment for companies that do not yet have a presence in each country; and
- promote industrial technology cooperation in various sectors including aviation, health/medicine, big data, renewable energy and agri-food.

As the first Asian country having signed an FTA with Israel, Korea would have a better position to preoccupy the Israeli markets and expect a trade expansion with the country. In addition, the Korea-Israel FTA is the first free trade agreement that Korea has signed containing a technology chapter. This chapter can provide a solid basis to expand technological cooperation with Israel which possesses source technologies supporting future industrial innovation, such as big data, information and communications technology, biotechnology, renewable energy and aviation. Further, there are high expectations that bilateral cooperation measures stipulated by the technology chapter would contribute to stimulating the creation of Korea's start-up ecosystem, fostering promising start-ups as well as ventures and securing a new growth engine.

Reporting Requirement for Foreign Bank and Financial Accounts with an Aggregate Balance of More than KRW 500 Million

Korean residents and domestic companies must report by June 30, 2021 their foreign bank and financial accounts whose aggregate balance exceeds KRW 500 million at any month-end during 2020. Foreign financial accounts refer to the accounts opened for financial transactions at offshore financial companies having the financial assets such as cash, stocks, bonds, collective investment securities, insurance policies and derivatives. While the reporting can be made online on the National Tax Service (NTS) homepage (www.hometax.go.kr), mobile app reporting is also available from this year. After this reporting period, the NTS will examine compliance with the reporting requirement with a focus on the appropriateness of detailed reporting. For the failure to comply with the reporting requirement, a penalty of up to 20% of the unreported amount will be imposed. Where an underreported or unreported amount exceeds KRW5 billion, personal information may be disclosed to the public and a criminal punishment may be imposed.

Rulings Update

Interpreting 'fair market value' of listed shares in applying the rule for denial of unfair transaction to the capital gains from the listed share transfer by an individual

Under the Individual Income Tax Law (IITL) and Corporate Income Tax Law (CITL), in a transaction between domestic related parties, the Korean tax authority can recalculate the taxable income of a transaction party based on the fair market value (FMV) of the transaction, whose tax burden is unreasonably reduced via the transaction not executed at FMV (so-called, 'the rule for denial of unfair transactions'). Based on Article 167(5) of the Presidential Decree of the former IITL (effective prior to the amendment on February 3, 2017), in applying the rule for denial of unfair transactions to the capital gains earned by an individual, the FMV should be calculated by applying the valuation method under the Inheritance and Gift Tax Law, requiring listed shares to be valued at their average closing price for two months before and after the transfer date plus a certain premium where the shares are transferred by the largest shareholder of the listed company. On the other hand, Article 89(1) of the Presidential Decree of the former CITL (effective prior to the amendment on February 17, 2021) concerning the application of the rule for denial of unfair transactions to a corporation provided that the FMV of listed shares traded on the Korea Exchange should be the closing price on the share transfer date.

Further, according to Article 167(6) of the Presidential Decree of the former IITL, where any asset is transferred between an individual and a corporation that are related parties, and the rule for denial of unfair transactions under the CITL does not apply to the corporation transacting with the individual, the rule for denial of unfair transactions would not apply to the capital gains of the individual.

In this dispute case, the largest individual shareholder in a listed Korean company sold some of the listed shares to a corporation having a special relationship with the shareholder at a price lower than the closing price of the listed shares on the transaction date through after-hours block trading on the Korea Exchange. The concerned district tax office argued that the rule for denial of unfair transactions should be applied for the purpose of

recalculating the capital gains earned by the individual shareholder based on the FMV under Article 167(5) of Presidential Decree of the former IITL, i.e., the average closing price for two months before and after the transfer date plus a certain premium. However, the individual shareholder contended that the rule should apply based on the FMV under Article 89(1) of the Presidential Decree of the former CITL (i.e., the closing price of listed stocks traded on the Korea Exchange on the transaction date) by arguing that Article 167(6) of the Presidential Decree of the former IITL would be intended to match FMV applicable to the related party transactions of individuals and corporations based on the FMV under the CITL.

For the dispute case, the Supreme Court decided that Article 167(6) of the Presidential Decree of the former IITL should not be treated as the regulation intended to match FMV applicable to the related party transactions of individuals and corporations based on the FMV under the CITL and it should not apply to the case as the share transfer was not made at the closing price of the listed shares on the transaction date which was FMV under the CITL. Therefore, the Supreme Court ruled that for the purpose of recalculating the capital gains of the individual shareholder from the transfer of the listed shares, the rule for denial of unfair transactions should apply based on the average closing price for two months before and after the transfer date plus a certain premium. (*Daebeop2016du63439, 2021. 5. 7*.)

The Supreme Court decision in this case may be meaningful since it first ruled that Article 167(6) of the Presidential Decree of the former IITL would not be intended to match the FMV used for applying the rule for denial of unfair transactions for individual income tax purposes with the FMV under the CITL.

Meanwhile, please note that the recently amended Presidential Decree of the IITL, effective from February 17, 2021, contains a new provision in Article 167(7) that FMV for listed shares under the IITL shall refer to the FMV as stipulated in Article 89(1) of the Presidential Decree of the CITL. In addition, please be informed that the recently revised Article 89(1) of the Presidential Decree of the CITL effective from February 17, 2021 included a new provision concerning the determination of FMV for listed shares.

Clawback of exempted acquisition tax upon a tax qualified merger between a parent and its 100% owned subsidiary or the subsidiaries wholly owned by the same parent

Where a merger between domestic companies meets all of the requirements for a tax qualified merger under the CITL, among others, a dissolving company can claim the tax deferral of capital gains from the transfer of asset upon the merger. Also, based on Article 44(3) of the CITL, a merger between a parent and its wholly-owned subsidiary or the wholly-owned subsidiaries of the same parent would be treated as a tax qualified merger for CITL purposes although it does not meet the requirements for a tax qualified merger. Further, according to Article 44-3(3) of the CITL, such tax qualified merger between the parent-its wholly owned subsidiary or the subsidiaries wholly owned by the same parent would not be subject to the clawback of income tax benefits (e.g., tax deferral of capital gains from the merger) claimed upon a tax qualified merger even if any of subsequent events triggering the clawback under the CITL would arise.

Meanwhile, according to Article 57-2(1) of the Special Treatment & Control Law on Local Taxes, where business assets are acquired by no later than December 31, 2021 through a tax qualified merger under the CITL, a partial exemption of the acquisition tax on the assets acquired from the merger shall be available. However, Article 57-2(1) further provides that the clawback of exempted acquisition tax would occur in the year when any of subsequent events triggering the clawback under the CITL would arise within three years from the merger registration date.

The issue in this case was whether the clawback of exempted acquisition tax should apply to a tax qualified merger between a parent-its 100% owned subsidiary or the subsidiaries wholly owned by the same parent if one of the subsequent events triggering the clawback under the CITL takes place, regardless of the exception of the clawback to such merger for corporate income tax purposes.

The Ministry of Interior and Safety issue a tax ruling interpreting that the clawback of exempted acquisition tax should apply to a tax qualified merger between a parent and its 100% owned subsidiary or the subsidiaries wholly owned by the same parent if any of the subsequent events triggering the clawback of income tax benefits from a tax qualified merger under the CITL take places within three years from the merger registration date. This tax ruling was based on the ground that the concerned provision under the Special Treatment & Control Law on Local Taxes only states the clawback of exempted acquisition tax for a tax qualified merger in case of any subsequent event triggering the clawback under the CITL and it does not provide an exception of the clawback rule for the merger between a parent-its 100% owned subsidiary or the subsidiaries wholly owned by the same parent for local tax purposes. (*Local Tax Special Treatment Policy Division-697, 2021.3.23*)

According to the Ministry's recent ruling, whereas a tax qualified merger between a parent-its 100% owned subsidiary or the subsidiaries wholly owned by the same parent would not be subject to the clawback rule for corporate income tax purposes, the clawback of exempted acquisition tax for such tax qualified merger should be separately considered where any of subsequent events triggering the clawback under the CITL occurs. Together with this Ministry's ruling, it may be necessary to refer to the Tax Tribunal decision providing similar interpretation (*Joshim2017ji 0241, 2017. 5. 17*.).

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