Korean Tax Update

Samil Commentary

September 15, 2020

MLI Entering into Force in Korea on 1 September

As Korea deposited with the OECD its instrument of ratification for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI") on 13 May 2020, the MLI has come into force in Korea on 1 September 2020. The MLI had been signed by Korea on 7 June 2017 and the national procedures were completed and approved by Korea's National Assembly on 10 December 2019.

Korea notified the existing bilateral tax treaties with 73 countries including China, France, Hong Kong, Japan, UK, US, etc. as covered tax agreements (CTAs) for the MLI. Out of those 73 countries, 32 countries (e.g., France, India, Japan, Ireland, UK) notified the tax treaties with Korea as CTAs for the MLI. As a result, the 32 CTAs of Korea shall be revised by the MLI depending on the MLI position of both contracting states.

With the entry into force of the MLI, Korea shall comply with minimum standards of the MLI provisions that are required to implement as a party for the MLI. One of the most important MLI provisions adopted by Korea is the provision to prevent treaty abuse where a benefit under the CTA shall not be granted in respect of an item of income or capital if it is reasonable to conclude under all relevant facts and circumstances that obtaining that benefit was one of the principal purposes of any arrangement or transaction.

Another important provision adopted by Korea allows a taxpayer to choose the competent authority of either contracting state for mutual agreement procedure and present a case to resolve cross-border tax dispute as compared with the existing tax treaties which require a taxpayer to present the case to the competent authority of the state where the taxpayer is a resident. (*For more details, please refer to Samil PwC TaxTalk Alert, 1 September 2020*)

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Tax Tribunal Reshuffle for Organizational Expansion

Following the amendment of the rule concerning the organizational structure of the Office of Government Policy Coordination and subordinate government agencies including the Tax Tribunal, the Korean government proclaimed the amended rule on 8 September 2020. The amended rule results in a change to the organizational structure of the Tax Tribunal including an increase in the number of the judges and investigators to deal with national and local tax appeal cases. Specifically, two additional judges shall be nominated by the Prime Minister and appointed by the President, and two additional investigators in charge of investigating requests for adjudication shall join the Tax Tribunal. Also, 12 public officers in charge of administration shall be reallocated to handle both administration and tax affairs in order to improve the efficiency of resource management of the Tax Tribunal.

The reallocation of resources will change the organizational structure of the Tax Tribunal. six judgement divisions (formerly, five divisions) will be in charge of domestic tax cases while two judgement divisions (formerly, one division) will deal with local tax cases. Also, while there will be three investigator offices under the judgement division 2 in charge of small domestic tax cases and customs duties (as in the existing structure), there will be two investigator's offices each under the judgement division 1, 3, 4, 5 and 6 dedicated to domestic tax cases. In addition, there will be four investigator's offices under the division 7 and 8 in charge of local tax cases. It is expected that the latest reshuffle in the Tax Tribunal's organizational structure will allow the Tax Tribunal to more swiftly process the appeal cases filed for taxpayers' reliefs.

Tax Reform Proposals Submitted to the National Assembly on 31 August

On 31 August 2020, the Ministry of Economy and Finance (MOEF) submitted to the National Assembly the tax reform proposals for 2020 after it announced the tax reform proposals for 2020 to amend 16 tax laws including the Corporate Income Tax Law, the Special Tax Treatment Control Law and the Basic National Tax Law on 22 July 2020 (*refer to Samil PwC Tax Newsflash July 2020 issue for details*). The government's tax reform proposals were finalized at the Cabinet meeting on 25 August 2020 after they were pre-announced to invite public comments from July 23 through August 12, 2020.

Rulings Update

Whether to appeal against a reduction of tax losses determined by the tax authority

Under the former Corporate Income Tax Law (CITL) (effective prior to the amendment on 31 December 2009), tax losses which could be deducted from the taxable income for a current year referred to "tax losses that were incurred within 10 years retroactively from the beginning of the current year but not deducted from the taxable income in calculating the tax base in past years." Later, the amended CITL effective from 31 December 2009 added the provision stating that "in such a case, deductible tax losses shall be limited to the tax losses which have been reported per the tax return originally filed, determined or amended by the tax authority, or reported per the revised tax return" (herein, 'limitation clause').

In this case, a taxpayer was notified by the tax authority of a reduction of tax losses incurred for the years from 2010 to 2014, and there was a dispute over whether a reduction of tax losses determined by the tax authority would constitute the administrative action which the taxpayer can file an appeal. In the previous cases held before the introduction of the limitation clause, the Supreme Court ruled that a reduction of tax losses determined by the tax authority would not be treated as the administrative action eligible for an appeal because taxpayers can argue for a proper amount of tax losses carried over from prior years in relation to the assessment of corporate income tax for a subsequent year after the reduction of tax losses was made by the tax authority. (*Daebeop2001du2652, 2002. 11.26*., etc.)

For the case at issue, the Supreme Court viewed that the limitation clause was included for the purpose of limiting the scope of deductible tax losses to the tax losses which were confirmed via tax return filing or the tax authority's assessment and promoting legal stability. As such, the Supreme Court decided that in light of the intent and the language of the limitation clause added to the CITL, after the introduction of the limitation clause, as long as the taxpayer would not pursue an appeal against the reduction of tax losses when a reduction of tax losses was made by the tax authority, it could not argue in a subsequent year that a reduction of tax losses made by the tax authority would be inappropriate or there would exist additional tax losses other than the tax losses determined by the tax authority unless there are special circumstances. Therefore, the Supreme Court judged that a reduction of tax losses made by the tax authority would form the administrative action directly affecting the taxpayer's tax liabilities and therefore, it would be subject to an appeal. (*Daebeop2017du63788, 2020.7.9*.)

This Supreme Court decision has importance in that the Supreme Court has rendered its first decision on the issue over whether a reduction of tax losses determined by the tax authority should be considered as an administrative action subject to appeal after the introduction of the limitation clause under the amended CITL (effective from 31 December 2009). Further, it is meaningful by implying that in case where there is a reduction of tax losses determined by the tax authority, an appeal must be filed within 90 days from the date when such determination is made by the tax authority.

Whether the payment to a Singapore company for the use of containers would be subject to tax in Korea

Pursuant to the revised Korea-Singapore tax treaty which entered into force on 31 December 2019, any kind of payment received as a consideration for the use of, or the right to use industrial, commercial or scientific equipment is excluded from the scope of royalties subject to withholding tax in Korea. For the entry into effect, the revised tax treaty states that in respect of taxes withheld at source, for amounts payable on or after the first day of January in the first calendar year (i.e., 1 January 2020) following that in which the revised treaty enters into force.

The issue in this tax ruling was whether the payment for the use of leased containers by a domestic company to a Singapore company having no permanent establishment (PE) in Korea should be subject to Korean withholding tax where the domestic company's payable

arises for the use of leased containers during December 2019, but it actually makes the payment in January 2020.

In this tax ruling, the National Tax Service (NTS) replied that if a Singapore company having no PE in Korea mainly conduct container leasing business, the payment for the leased containers to the Singapore company made on or after 1 January 2020 would not be subject to Korean taxation under Article 7 and Article 12 of the revised tax treaty while it should fall under 'Korean sourced rental income' according to item 4, Article 93 of the CITL. (*Advance Ruling -2020-Beopryunghaeseokgugjo-0175, 2020. 7. 1*.)

This tax ruling issued by the NTS confirms that a consideration for the use of industrial, commercial or scientific equipment is excluded from the scope of royalties under the revised tax treaty and in respect of taxes withheld at source, the revised tax treaty shall apply for payments made on or after 1 January 2020.

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