NEWSLETTER

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Tax Group

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Key Tax Law Amendments in the Draft 2020 Tax Revision Bill

On July 22, 2020, the Ministry of Economy and Finance publicly released the 2020 draft Tax Revision Bill (the '**Draft Bill**').

Amidst the increasing risk of a global recession caused by the COVID 19 pandemic, the Draft Bill aims to: (i) promote investment and spending; (ii) enhance tax benefits to low-income earners and mid-sized and small-sized enterprises; and (iii) provide tax incentives for job creation in order to minimize the negative economic impact of COVID 19. The Draft Bill is also seeking to harmonize the Korean tax system to changes occurring in the global economy, to ease compliance burdens, and to avoid double taxation.

A summary of some key tax law proposals in the Draft Bill is provided below.

I. Dealing with the negative impacts of COVID 19 and invigorating the economy to prevent a post-COVID 19 recession

1. Extension of the carryforward period for tax deductions provided under the Special Tax Restriction Law ('STRL') (Article 144 of the STRL)

This proposal would extend the carryforward period to 10 years for all tax deductions provided under the STRL. The proposal is meant to reduce the investment risks of businesses. The proposed extended period will also apply to existing carryforward periods not expired as of the end of 2020.

2. Extension of the carryforward period for tax losses (Articles 13 and 17(13) of the Corporate Income Tax Law ('CITL') and Article 45 of the Individual Income Tax Law ('IITL'))

This proposal would extend the period for tax loss carryforward from the current 10 years to 15 years, in order to reduce the tax burden faced by businesses that have suffered economic loss as a result of the COVID 19 pandemic. This proposal will be effective for tax losses reported on or

after January 1, 2021 (i.e., including the tax loss reported in the 2020 tax return).

3. **Extension of the carryforward period for unused foreign tax credits and deductions of uncredited foreign tax after the carryforward period (Article 57 of the CITL, Article 57 of the IITL)**

   This proposal would extend the period for foreign tax credit carryforward from the current 5 years to 10 years. The proposal is intended to limit the impact of double taxation on cross-border transactions. The amount of uncredited foreign taxes remaining after the extended carryforward period will be deducted as an expense from the taxable income in the tax year immediately following the end of the carryforward period.

   The extension will also apply to existing carryforward periods not expired as of the end of 2020.

4. **Introduction of a new tax regime for financial investment income (Article 4, Article 87-2, Article 87-4 to 87-26, Articles 127 - 129, Article 148-2(3) of the IITL)**

   Currently, interest and dividend income is subject to tax. The Draft Bill will expand the rules to provide that all types of income that can be generated from the sale or disposal of financial assets (e.g. securities, derivatives, etc.) as defined in the Financial Investment Services and Capital Markets Law will be subject to tax. Capital gains generated from the transfer of debt securities or listed shares held by minority shareholders, currently exempt from tax, will eventually be subject to tax.

   The proposal also prescribes the methods of calculating necessary costs, a basic deduction of KRW 50 million, tax reductions, and the carryforward of financial investment losses (for 5 years) in relation to the new tax regime. According to the proposal, the financial investment income will be the net gains (or losses) on the financial instruments for each tax period (from January 1 to December 31), which will be classified into: (1) capital gains from the transfer of domestic listed stocks; or (2) income from foreign stocks, non-listed stocks, debt securities, and derivatives. Depending on the classification, a prescribed amount (KRW 50 million for domestic listed stocks; KRW 2.5 million for others) will be deducted from the financial investment income and the non-deducted amount will be allowed to be carried forward for 5 years.

   With respect to filing tax returns and making tax payments for financial investment income, the proposal would require financial institutions to withhold tax (generally at the rate of 20%) from the financial investment income calculated monthly for each taxpayer. If there is financial investment income generated other than through a financial institution, then this income is subject to a preliminary tax return semi-annually. A taxpayer should file a final tax return and provide information of his tax base and tax amount from financial investment income, by the end of the 5th month of the following year. In addition, there is a new higher progressive tax rate of 25% on financial securities income, and to the extent that the higher rate is applicable, then additional tax shall be paid

in the final tax return, or alternatively, to the extent that a tax refund is due, due to the netting of gains and losses, a final tax return should be filed.

This proposal will be effective for financial investment income generated on or after January 1, 2023.

5. Rationalization of the tax regime for trust-type collective investment vehicles ('CIVs') (Article 4(17) of the IITL, Article 91-2 of the STRL)

This proposal provides for all income attributed to a CIV to be subject to tax, unless otherwise provided. The proposal is designed to tax certain profits of a CIV which are currently not subject to taxation.

Based on the Draft Bill, the following changes will be made: (i) income distributed by a CIV will be classified as dividend income or as financial investment income depending on its source; (ii) income generated by a qualified CIV will be taxed on a net basis and a carryforward of deductions will be allowed; (iii) by contrast, unqualified CIVs will be treated as entities subject to tax.

The proposal would require the submission of a report which provides information about the annual income from trust assets and details of the distribution and reserve details as an additional condition to be a qualified CIV under the Income Tax Law. According to the proposal, if an unqualified CIV does not distribute its interest or dividend income, the retained earnings of the unqualified CIV will be subject to corporate income tax and the beneficiaries will be deemed to receive dividend income, which shall be taxed again.

6. Reduction in the securities transaction tax ('STT') rate (Article 8 of the Securities Transaction Tax Law ('STTL') and Article 5 of the Enforcement Decree of the STTL)

In consideration of a newly introduced taxation regime for financial investment income and expanded taxation on capital gains from the transfer of stocks, the proposal would reduce the STT rates. Between 2021 and 2022, the STT rate will be reduced by 0.02% points. From 2023, when the financial investment income starts to be fully implemented, the following STT rates will apply: 0% for securities traded at KOSPI; 0.15% for KOSDAQ; 0.1% for KONEX; and 0.35% for others.

II. Expanding and promoting social inclusion and fairness

7. Adjustment in the highest individual income tax ('IIT') rate (Article 55(1) of the IITL)

The proposal would raise the income tax rate from 42% to 45% for the individual taxpayers who receive more than KRW 10 billion of taxable income. The adjustment in the highest ITT rate aims to enhance fairness in taxation and strengthen the income redistribution function of taxation. The proposal will be effective for income generated on or after January 1, 2021.

8. **Increase in the comprehensive real estate holding tax ('CREHT') rate for residential housing and introduction of a flat tax rate for corporations (Article 9 of the Comprehensive Real Estate Holding Tax Law ('CREHTL'))**

The proposal would increase tax on owners of residential housing. The proposal also aims to prevent indirect holding of multiple residential housing units through a corporation by applying flat CREHT rates (which are equal to the highest general tax rates) to residential housing held by corporations. The increased tax rates are summarized below.

- General Tax Rates

Two residential housing units or fewer (excluding cases where two residential housing units are held within a designated speculative zone)		Three or more residential housing units, or two residential housing units within a designated speculative zone	
Tax Base	**Tax Rate (%)**	**Tax Base**	**Tax Rate (%)**
KRW 0.3 billion or less	**0.6**	KRW 0.3 billion or less	**1.2**
More than KRW 0.3 billion - KRW 0.6 billion or less	**0.8**	More than KRW 0.3 billion - KRW 0.6 billion or less	**1.6**
More than KRW 0.6 billion - KRW 1.2 billion or less	**1.2**	More than KRW 0.6 billion - KRW 1.2 billion or less	**2.2**
More than KRW 1.2 billion - KRW 5.0 billion or less	**1.6**	More than KRW 1.2 billion - KRW 5.0 billion or less	**3.6**
More than KRW 5.0 billion - KRW 9.4 billion or less	**2.2**	More than KRW 5.0 billion - KRW 9.4 billion or less	**5.0**
More than KRW 9.4 billion	**3.0**	More than KRW 9.4 billion	**6.0**

Based on the proposal, the CREHT rates applied to corporations (excluding the corporations prescribed under the Enforcement Decree of the CREHTL) will be 3.0% of the statutory value for owners of two or more residential housing units (not within the designated speculative zones) and 6.0% of the statutory value for owners of three or more residential housing units or owners of two residential housing units within the designated speculative zones.

9. **Introduction of a new tax regime for income from trading virtual assets (Articles 14, 21, and 119 of the IITL and Article 92, 93, and 98 of the CITL)**

Under the general principle of the current income tax laws, unless certain income is explicitly specified as a type of income that is to be taxed under the relevant tax law, the income is not taxable (Positive List System). Accordingly, income from virtual assets, which are not currently specified under the income tax laws, has not been subject to tax in Korea. The proposal would introduce a statutory basis to tax the income from virtual assets as 'other income'. This proposal will be effective for virtual assets transferred or leased on or after October 1, 2021.

A. Taxation of a domestic tax resident for the transfer of virtual assets

If a domestic tax resident transfers a virtual asset, income from the transfer will be taxed as other income. Income from virtual assets will be taxed on a net basis and the annual amount of net income not exceeding KRW 2.5 million will be exempt from tax. In addition, the income from virtual assets will not be included in the tax base for the comprehensive income taxation and will be taxed separately at the rate of 20%.

B. Taxation of a non-resident or a foreign company for the transfer of virtual assets

If a non-resident or a foreign company transfers a virtual asset in Korea, income from the transfer will be taxed as domestic source other income. If the virtual asset is transferred or redeemed through a business entity trading virtual assets, the business entity is required to withhold the lower of 10% of the sales proceeds or 20% of the realized gain, and pay the withholding tax by the 10th day of the following month. If the non-resident or the foreign company is entitled to receive benefits under a relevant tax treaty, exemption from the withholding tax is allowed, provided that an application for non-taxation or tax exemption is submitted to the business entity.

10. Mandatory reporting of the virtual asset trading accounts under the foreign financial account reporting requirement (Articles 34, 2, and 3 of the International Tax Coordination Law ('ITCL'))

In order to secure information about revenue sources of overseas investments in virtual assets, the proposal would stipulate that the accounts established for trading virtual assets or any other assets of a similar nature under the Act of Special Financial Transaction Information shall be subject to the foreign financial accounts reporting requirement.

11. Improvement of mutual agreement procedure ('MAP') between tax authorities (Articles 22, 23, and 27 of the ITCL)

The proposal would establish a new regulation preventing conflict between a MAP result and domestic court decisions. Based on the proposal, the agreement reached through a MAP will be executed, provided that both of the following conditions are satisfied:

(1) The taxpayer who initiated the MAP accepts the agreement reached through the MAP; and

(2) The taxpayer withdraws any tax appeals or tax litigation where a MAP and a tax appeal or litigation were proceeding simultaneously.

Moreover, the proposal would establish a statutory basis under the domestic tax laws to resolve international tax disputes through arbitration. Arbitration panels will be composed of three arbitrators in total – one arbitrator appointed by each respective competent authority, and one third-party arbitrator.

12. Expansion of the scope of passive income in relation to controlled foreign corporation ('CFC') regulations for specific foreign companies' retained earnings (Article 17(3) of the ITCL)

To encourage distribution of excess retained earnings of certain foreign companies controlled by Korean shareholders, if the CFC has passive income that exceeds a certain threshold, the passive income of that CFC shall be taxed regardless of the business it carries out. Currently, passive income means the income generated from: (i) holding stocks or debt securities; (ii) providing intellectual property rights; (iii) leasing ships, flights or equipment; or (iv) investing in an investment trust or fund. The proposal would expand the definition of passive income to include income generated from selling stocks or debt securities.

13. Revision of the regulations concerning the related party's burden of proof for customs duty (Article 30(4) and (5), Article 37-4(6) and (7) of the Customs Law)

The proposal would provide the head of a customs office a wide latitude in requesting submission of data. It will be codified that a failure to submit the requested data is a legitimate ground to deny the declared value from being considered as the transaction value (under the first designated method to decide the customs value for imported goods). The proposal aims to encourage the taxpayer's related parties, such as the head office or the Korean subsidiary of a multinational company, to submit accurate data and to balance the burden of proof between the tax authorities and taxpayers in a reasonable way. Key aspects of the current customs laws and the proposed amendments are compared below.

Legitimate Grounds to Deny the Transaction Value as a Proper Custom Value	
Current Customs Law	■ If a taxpayer fails to submit the requested data which can verify the declared price, or the data submitted upon request has not been prepared in compliance with generally accepted accounting principles ■ If there still exists a reasonable doubt as to the accuracy and authenticity of the declared transaction value even after the submission of the requested data
Proposed Amendment [Additional Grounds]	■ If the taxpayer's related party fails to submit evidential data which can verify that the declared value is the transaction value that meets the arm's length price of the relevant industry

Legitimate Grounds to Request Submission of Data from a Related Party	
Current Customs Law	■ If there is a substantial difference between the declared value and the transaction values of identical or similar goods
Proposed Amendment [Additional Grounds]	■ If there is a discrepancy between the declared value and the transaction value of identical or similar goods by more than the ratio prescribed by the relevant Presidential Decree ■ If the transaction value does not sufficiently reflect the seller's costs and profits ■ If the declared value is not in compliance with the practice of the relevant industry in deciding the arm's length price

The proposal is expected to make the preparation of evidential data by related parties for a customs review substantially more difficult, and increase the rigor with which the review is carried out by the customs office.

This proposal will be effective for data submission requests made on or after January 1, 2021.

14. Imposition of additional penalty not exceeding KRW 200 million on a party related to a taxpayer, for failing to submit data when requested (Article 277(1) of the Customs Law)

Under the current Customs Law, if a party related to a taxpayer fails to submit data requested by the head of a customs office, or submits false information, the taxpayer may be subject to a penalty not exceeding KRW 100 million. In order to encourage compliance with data submission obligations, the proposal would revise the Customs Law so as to levy additional penalty up to KRW 200 million, even if a penalty has already been levied.

The proposal will be effective for cases where the first penalty is levied on or after January 1, 2021.

15. Expansion of the circumstances where an amended import calculation statement can be issued (Article 35(2) of the Value Added Tax Law)

Under the current Value-Added Tax Law, an import VAT invoice can be amended (i) when an importer files a corrected import declaration before the head of a customs office determines or rectifies the tax base or amount of customs duty; or (ii) when an importer files a corrected import declaration knowing in advance that the tax base or the amount of customs duty will be determined or rectified following a customs investigation by a customs office. But in the latter case, the amendment of the import VAT invoice is allowed only if the revision is not caused by the importer or merely caused by the importer's minor mistake or fault. In order to protect taxpayers, the proposal would revise the VATL to delete the condition that the importer must prove he has committed no fault or just a minor fault.

Please note that certain situations will be excluded from the scope of this revised law, and so in these cases the import VAT invoices will not be able

to be amended: when a party related to the taxpayer has failed to submit requested information and so a penalty is levied, or where a taxpayer is subject to criminal charges relating to fraudulent reporting or intentional destruction of documents.

This proposal will be effective for tax returns reported or tax assessments imposed on or after January 1, 2021.

16. Imposition of a penalty tax for imported goods exempt from customs duties (Articles 42 and 42-2 of the Customs Law)

The proposal would impose a penalty tax if a taxpayer under-reports or fails to report the customs value of imported goods, even when the ordinary tax rate or any applicable special tax rate for the imported goods is 0%, or when the imported goods are exempt from customs duties.

The amount of penalty tax and any reduction thereof will be calculated as provided in the below table.

Type	Calculation of Additional Customs Duty	Reduction Ratio and Reason for Reduction of Additional Customs Duty
When the customs value is decided based on the price of imported goods	1) In the case of under-reporting, 0.8% of the under-reported customs value 2) In the case of no reporting, 1.6% of the unreported customs value 3) In the case of an illegal act, 3.2% of the unreported customs value	1) 100% Reduction In cases where an amended report is filed before the acceptance of an import declaration or where a provisional value is filed 2) 10-20% Reduction In cases where an amended report is filed within 1.5 years after the end of the revision period
When the customs value is decided based on the number of imported goods	1) In the case of under-reporting, 10% of the basic customs rate x the under-reported customs value 2) In the case of no reporting, 20% of the basic customs rate x the unreported customs value 3) In the case of an illegal act, 40% of the basic customs rate x the unreported customs value	

The proposal will be effective starting from January 1, 2021.

17. Extension of the period of validity for a tariff classification decided in an advance ruling (Articles 86(7) and 87(5) of the Customs Law)

Under the current Customs Law, a tariff classification decided by an advance ruling or modified through the review of an advance ruling is valid for three years. In order to impose customs duty in a more consistent and predictable manner, the proposal would extend the period of validity for a tariff classification so that it would be valid until

any change or modification is made to the classification (or in the case of a modified tariff classification, until a further change or modification is made).

This proposal will be effective starting from January 1, 2021.

18. Revision of the statute of limitations for tax appeals when a request for review has been made by a country of origin (Article 21(2) of the Customs Law)

Under the current Customs Law, where a request has been made by a country of origin to certify whether a certain bound tariff rate is applicable, the statute of limitations for appealing is one year from the date when a decision is received from the country of origin. The proposal would revise the statute of limitations so that the new limitation period would be the earlier of: (a) one year from the date when a decision is received from the country of origin; or (b) one year from the date when the statutory review period in the country of origin expires.

This proposal will be effective for cases where the review period expires on or after January 1, 2021.

19. Reduction in the customs duty rate for all types of 'mass flow controllers' used in manufacturing semiconductors (The Customs Act, Appendix)

Under the current Customs Law, the customs duty rate applied to a mass flow controller used in manufacturing semiconductors is 3% for liquid or air pressure type controllers, and 8% for electric or other type controllers. The proposal would revise the customs law to apply a consistent rate of 3% to all types of mass flow controllers used in manufacturing semiconductors.

This proposal will be effective starting from January 1, 2021.

20. Improvement of the regulations for suspending customs clearance (Article 237 of the Customs Law)

The proposal is to stipulate that if any tax treaty or other international law is violated, the head of a customs office may decide to suspend customs clearance. The proposal is expected to improve the effectiveness of the regulation that allows suspension of customs clearance. In order to better protect taxpayers, the proposal would also formalize the process of suspending customs clearance. The proposed amendment would provide a specified process for: (i) a notice or request by the head of the customs office to an owner of goods or an import or export applicant; and for (ii) a request by an owner of goods to end the suspension of customs clearance.

The proposal will be effective for customs clearances suspended on or after January 1, 2021.

III. Others

21. Transfer of tax law provisions allowing tax deductions for private equity funds from the CITL to the STRL (Deletion of Article 51(2) of the CITL, Enactment of Article 104(32) of the STRL)

Under the current CITL, private equity funds are allowed to deduct their distributed dividends from their taxable income, and there is no sunset clause which limits this right. Considering that this type of tax deduction provides special tax benefits to private equity funds, the proposal is to incorporate the regulations providing tax deductions for private equity funds into the STRL instead of the CITL. The proposal would also impose a new sunset clause, so that these tax deductions would only be permitted until December 31, 2022.

22. Extension of the period for retrospective application of an Advance Pricing Agreement ('APA') for the arm's length price calculation method (Article 6 of the ITCL)

Under the current tax laws, upon a taxpayer's application for an APA for an arm's length price calculation method, the Korean tax authority may accept such an application if it is mutually agreed with the competent authority of the other contracting state, and if there is in place a relevant tax treaty. Currently, upon the taxpayer's request, the Korean tax authority may also approve the application of the mutually-agreed APA retrospectively for a maximum retrospective period of 5 years. In the case of a unilateral APA which has been decided without a mutual agreement procedure, the maximum period of retrospective application is currently 3 years. In order to better protect taxpayers' rights, the proposal would extend the maximum period of retrospective application to 7 years for a mutually-agreed APA and to 5 years for a unilateral APA.

The proposal will be effective for APAs requested on or after January 1, 2021.

23. Elimination of expense deduction method for foreign tax credits (Article 57 of the CITL, Article 57 of the IITL)

This proposal has clarified that indirectly paid foreign taxes will be included in the taxable income, and foreign taxes paid or payable by a foreign subsidiary will not be deductible as expenses.

Currently, when a domestic company has either paid or is liable to pay foreign taxes, the company is entitled to choose between the tax credit method and the expense deduction method for the foreign tax credit. The proposal would eliminate the expense deduction method for foreign tax credits.

24. Improvement in the regulations requiring submission of a payment statement for domestic source income paid to a foreign company or a non-resident (Article 120-2 of the CITL, Article 164-2 of the IITL)

Under the current withholding tax regime, a person who pays domestic

source income to a foreign company or a non-resident is generally required to submit a payment statement with respect to any tax withheld at the time of payment. The proposal would require stock issuers to submit the payment statement, if existing unlisted stocks held by a foreign company or a non-resident are transferred at the time of initial offering at a registered stock exchange.

25. Expansion of the scope of re-exported goods eligible for customs duty reduction (Article 98(1) of the Customs Law and Article 54 of the Enforcement Decree of the Customs Law)

Under the current Customs Law, customs duty may be reduced if goods usable for a long period have been imported for a temporary use in Korea based on a lease contract or a work contract, and if such goods are exported afterwards within two years from the date on which the import declaration of the goods was accepted. In order to promote exports and support trading businesses, the proposal would allow a reduction in customs duty for goods which have been imported for the execution of an export contract, regardless of whether the goods are imported directly from the counterpart or indirectly through a third party, provided that such goods are exported afterwards within two years.

This proposal will be effective for import declarations made on or after January 1, 2021.

For more information pertaining to this newsletter, please contact the attorneys identified on the left.

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