

NEWSLETTER

August 2023

Tax Group

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Highlights of the FY2023 Tax Law Amendment Proposals

The Korean Ministry of Economy and Finance (**MOEF**) confirmed and announced the FY2023 tax law amendment proposals on July 27, 2023 (**Proposals**). According to the MOEF, the Proposals are geared towards: i) shoring up the private sector-driven economic vitality by further boosting exports, investments and domestic demand; and ii) easing tax burdens for companies and taxpayers, as well as broadening the tax base to overcome social structural problems in Korea, including the population decrease and regional inequality.

The Proposals are expected to be finalized (possibly with some modification) before being submitted to the National Assembly in the Fall this year. The National Assembly should enact the final version of the Proposals into Law in December of this year.

Some major international and corporate-related Proposals include the following:

1. Amendments related to Corporate Taxation

- **Legislation containing detailed application rules for the 15% global minimum tax (GloBE Rules); implementation and deferral of Undertaxed Payments**

Following the OECD's release of the 15% global minimum tax model rules (**OECD Model Rules**) and related commentary in December 2021 and March 2022 (respectively), Korea enacted into law its version of the GloBE Rules, effective as of January 1, 2024. Korea was the first jurisdiction to do so. The Korean GloBE Rules align closely with the OECD Model Rules, and include the Income Inclusion Rule (**IIR**), the Undertaxed Payments Rule (**UTPR**) and related Top-up Tax rules that are substantially the same as those in the OECD Model Rules.

Now, as many major jurisdictions move to introduce the GloBE Rules, the MOEF has proposed detailed implementation rules, by reference to the OECD Model Rules and related commentary, as part of the Proposals. These Proposals would be adopted into the Law for the Coordination of International Tax Affairs (**LCITA**) and the LCITA Presidential Decree. Some of the salient points of these Proposals are as below:

- Deferral in implementation of UTPR (and the related Top-up Tax rules) for one year, from fiscal year beginning on or after January 1, 2024 to January 1, 2025. However, the implementation schedule for the IIR would still remain the same (i.e., the fiscal year beginning on or after January 1, 2024.). This deferral is to address concerns over Korea's early implementation schedule of the UTPR compared with other jurisdictions.
 - Clarification and revision of the definition of certain terms, such as 'ultimate parent entity' and 'permanent establishment', in order to align the proposed Korean domestic rules with the OECD Model Rules and related commentary;
 - Rules governing the adjustment to GloBE income or loss amounts after filing GloBE Information Return triggered by filing of an amended tax return by the taxpayer or the Korean tax authority's tax assessment;
 - Allowing the tax authority to assess tax within 1 year from the date the tax authority becomes aware of the change in ETR for GloBE purposes, regardless of the general statute of limitations;
 - Transitional rules that exempt or reduce penalties for noncompliance of reporting and payment of Top-up Tax liability under IIR or UTPR; and
 - Clarification of how the Qualified Domestic Minimum Top-up Tax (QDMTT) rule in low-taxed jurisdictions interplays with the IIR.
- **Expansion of tax incentives for video contents investment (Article 25(6) and Article 25(8) of the Special Tax Treatment Control Law (STTCL))**

In order to secure the global competitiveness of the 'K-contents' entertainment industry, the tax credit rate for production costs of film and video contents is proposed to be significantly raised. Also, as part of the Korean government's plan to encourage investments into the K-contents industry, a special corporate tax deduction is proposed to be established for investment in companies specializing in arts and entertainment areas.

The basic tax credit rate for production costs of video contents such as TV programs, movies, and dramas is proposed to be raised from the current 3% for large companies, 7% for medium-sized companies, and 10% for SMEs; to 5%, 10%, and 13% respectively. Additional tax credit rates (10%, 15%) are applied to video contents that may have a large effect on the domestic industry. In addition, a tax credit of 3% is proposed to be available to SMEs and medium-sized companies which make investments via equity contributions into specified companies producing relevant video contents. This additional 3% tax credit would apply to production costs and/or investment made from January 1, 2024 and onwards.

- **Expansion of the scope of National Strategic Technology Sector and New Growth and Core Technology Sector eligible for research and human resources development expenditures related tax credits (R&D Tax Credit) (Appendix 7 and Appendix 7-2 of the Presidential Decree of the STTCL, Appendix 6-2 of the Special Rules of the STTCL)**

To foster R&D and investment in the biopharmaceutical industry, eight detailed technologies and four commercialized facilities related to the biopharmaceutical sector are proposed to be added to the qualified R&D Tax Credit (as national strategic technology). This would be applied to R&D expenditure incurred or facility investment made on or after July 1, 2023.

In addition, in order to support R&D for energy efficiency improvement and supply chain-related industries, essential technologies related to supply chains, such as core technologies for energy efficiency improvement and core mineral refining and smelting, are proposed to be added to the subject of the R&D Tax Credit (new growth and core technologies). The change would apply to expenditure incurred on or after January 1, 2024.

- **Easing requirements for income exclusion of dividends received from overseas subsidiaries by companies engaging in natural resources development activities (Article 18(4) and Article 57(5) of the Corporate Income Tax Law (CITL))**

In order to secure resources such as critical minerals and support vitalization of overseas resource development projects, the minimum shareholding threshold in overseas subsidiaries, which are eligible for indirect foreign tax credits or the participation exemption for overseas subsidiaries, is proposed to be lowered from 5% or more to 2% or more. This would be applied to dividends received on or after January 1, 2024.

- **Rationalization of the scope of application for partnership taxation election (Article 100(14) - 100(18) of the STTCL, Article 100(18) of the Presidential Decree of the STTCL)**

In order to eliminate double taxation on private collective investment vehicles (CIVs), the special partnership election (i.e., tax exemption election) is proposed to also apply to the upper-tier funds that invests in the sub-funds. This would be applied to those CIVs which apply for tax exemption starting from January 1, 2024 (or in the case of companies established in 2023, if they apply by January 31, 2024).

- **Rationalization of the scope of exceptions to non-taxation in relation to capital reserves (e.g., additional paid-in capital (APIC)) (Article 12 of the Presidential Decree of the CITL, Article 18 of the CITL)**

In order to improve tax equity and prevent tax avoidance, APIC in excess of par value of redeemable stocks issued is proposed to be added to the scope of taxable deemed dividends as an exception to the exemption from taxation in the case of conversion of capital reserves to capital under the Korean Commercial Code. This would be applied to capital conversion incurred after the effective date of the Presidential Decree.

In addition, as exceptions to exclusion from taxable income in the case of dividends paid out of a certain excess capital reserve balance, APIC in excess of par value of redeemable stocks issued, 3% revaluation reserve of the merged company among gains arising from a merger in case of a qualified merger, and 3% revaluation reserve of the split company among gains arising from a split in case of a qualified split are proposed to be added to the scope of prescribed capital surplus subject to the exceptions, from which dividends received are included in taxable income. This would be applied to dividends paid on or after January 1, 2024.

2. Amendments related to Individual Taxation

- **Five-year extension of the application timeline for concessional flat tax rate for qualified foreign workers (Article 18(2) of the STTCL)**

In order to attract more foreign workers into Korea, it is proposed to extend the application timeline for flat tax rate (20.9%, inclusive of local tax) applicable to qualified foreign workers for 5 years. Currently, the flat tax rate applies to income earned in Korea for a period of 20 years, starting on the employee's first day of work in Korea, provided this first day was no later than December 31, 2023. The Proposals would push this date back another 5 years until December 31, 2028.

Foreign workers who opt to apply the concessional flat tax rate are not eligible for any income deductions or tax deductions/exemptions/credits including employer-provided housing benefits. To ameliorate the attractiveness of this concessional flat tax rate for foreign workers, the proposed amendment allows foreign workers to exclude employer-provided housing benefits from their taxable income until December 31, 2023.

- **Obligations for employees of domestic subsidiaries of foreign companies to submit transaction details of overseas stock-based compensation (Newly established Article 164(5) of the Individual Income Tax Law (IITL) and Article 216(5) of the Presidential Decree of the IITL)**

It is proposed that employees working at domestic subsidiaries or permanent establishments (PE(s)) of foreign parent companies will be obligated to submit transaction details for stock-based compensation received from the foreign parent companies. Stock-based compensation refers to stocks, stock options, and bonuses paid in cash corresponding to the increase in stock value, and domestic subsidiaries or branches of foreign companies are subject to the submission requirement. This would be applied to those who exercise or receive stock-based compensation on or after January 1, 2024.

- **Relief of tax burden for family business succession (Article 30(6) of the STTCL, Article 71 of the Inheritance Tax and Gift Tax Law, Article 27(6) of the Presidential Decree of the STTCL)**

To support the smooth family business succession of SMEs, the lowest bracket for the gift tax rate (10%) in relation to family business succession is proposed to be increased from (i) KRW 1 billion - 6 billion to (ii) KRW 1 billion - 30 billion, and the annual installment payment period is proposed to be drastically increased from 5 years to 20 years. This would be applied to assets gifted on or after January 1, 2024.¹⁾

3. Others

- **Shortening the deadline for submitting the master file and local file (Article 16 of the LCITA)**

In order to strengthen tax source management for international transactions, the Proposals provide that the deadline for submitting the master file and local file would be shortened from the current 12 months after each fiscal year end to 6 months after each fiscal year end, while the deadline for jurisdiction-by-jurisdiction reporting would remain the same (i.e., 12 months after each fiscal year end).

1) In Korea, Gift Tax is borne by the donee.

- **Establishment of special taxation rules for foreigner's omnibus account (Article 119(4) of the IITL, Article 93(4) of the CITL)**

In order to rationalize the taxation method for a foreigner's omnibus account opened at domestic securities firms by foreign securities and management companies to order and settle stock trading in Korea, the Proposals provide for new regulations on taxation of foreign omnibus accounts. When investing through a foreigner's omnibus account, it is proposed that the payor of income must withhold tax from the account holder of the omnibus account, and at this time, non-taxation, exemption, and reduced tax rates under tax treaties are not applicable. Beneficial owners and income payors who wish to receive tax exemption and reduced tax rates under tax treaties after withholding tax can apply for a refund. This would be applied to the income paid on or after January 1, 2024.

- **Obligation to submit details of foreign trusts (Article 58, 59 and 91 of the LCITA)**

In order to strengthen the management of offshore tax sources, the Proposals provide that trust grantors are obligated to submit data such as basic information and property values of the trusts. When a resident or a domestic company sets up an overseas trust or transfers property to an overseas trust, the grantor is obligated to submit data per each case. After the trust is established, if the grantor, who is a resident or a domestic company, actually controls the trust property, he or she is obligated to submit such data every year.

- **Laying grounds for the formation of a consultative committee for tax treaty implementation (Newly established Article 42(6) of the LCITA)**

In order to facilitate the implementation of tax treaties and regularly discuss cooperation matters in the field of international taxation, as well as to establish a legal basis for the establishment and operation of a consultative committee for tax treaty implementation, a joint consultative forum between contracting jurisdictions is proposed to be established. Once this is legislated, from the perspective of taxpayers, it is expected to increase the possibility of resolving tax disputes arising from the different interpretations of tax treaties.

- **Imposition of penalties on foreign electronic service providers for failure to register under the Digital VAT regime (Article 60(1) of the Value Added Tax Law (VAT Law), Article 11(6) of the Presidential Decree of the VAT Law)**

In order to enhance the effectiveness of the Digital VAT regime for foreign electronic service providers without a PE in Korea, the Proposals introduce a penalty system whereby foreign electronic service providers are also subject to a non-registration penalty in Korea. It is proposed that this would be applicable starting on or after January 1, 2024.

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