Lee & Ko

NEWSLETTER

September 2021

Tax Group

CONTACT

Jay SHIM

T: +82.2.2191.3235
E: jay.shim
@leeko.com

Tom KWON

T: +82.2.6386.6627
E: tom.kwon
@leeko.com

Ted Tae-Gyung KIM

T: +82.2.2191.3246
E: ted.kim
@leeko.com

Yeon Ho CHANG

T: +82.2.772.5942
E: yeonho.chang
@leeko.com

Tax Alert - the Korean Ministry of Economy and Finance Announces 2022 Tax Amendment Proposals

On July 26, 2021, the Ministry of Economy and Finance announced the government's tax amendment proposals for 2022 (**the Proposals**). The Proposals are intended to (i) encourage economic recovery from the COVID-19 pandemic, facilitate job creation and drive the growth of industry sectors that will boom in the post-COVID era; (ii) reduce the economic inequality that has worsened during the COVID-19 pandemic by giving tax benefits to small and medium sized enterprises and low-income households; and (iii) improve the tax system and strengthen taxpayer protection.

The Proposals have been submitted to the Korean National Assembly on September 3, 2021. If approved by the National Assembly, and unless otherwise specified below, the Proposals will become effective as of January 1, 2022.

This Tax Alert summarizes some of the key Proposals that may impact foreign investors.

1. New limitation on deduction of tax loss carryforwards in case of business transfers

The Proposals include a new rule to limit the deduction of tax loss carryforwards following a transfer of business. The new rule aims to prevent business transfers from being used as a means of tax avoidance. Under the new rule, when a loss-making company acquires more than 70% of the assets and 90% of net assets of a related party, the acquiring company may only utilize tax loss carryforwards to the extent the tax loss carryforwards are attributable to income arising from the acquiring company's original business. The acquiring company therefore will need to maintain separate accounts for its original business and the transferred business.

2. New requirements for liaison offices in Korea to submit information

The Proposals also introduce a new rule requiring foreign companies that maintain liaison offices in Korea to report certain information on the status of their liaison office by February 10 of the year following the relevant fiscal year. The required information would include basic information about the Korean liaison office, the status of the foreign head office and other branches in Korea, and a list of Korean

customers/clients.

3. New VAT documentation requirements for foreign electronic service providers

Currently, where a foreign company or a nonresident provides certain electronic services to Korean customers, such as computer games, mobile applications, audio and video files, software, and cloud computing services, they are subject to simplified VAT compliance requirements. The Proposals would impose new compliance requirements on those foreign companies or nonresidents, requiring them to maintain details of their relevant transactions for 5 years and, if requested by the tax authorities, to submit those details within 60 days from the request date.

4. Clarification of beneficial ownership requirements for overseas investment vehicles

Where Korea source income is paid to a foreign company through an overseas investment vehicle (**OIV**), the current tax law provides that the foreign company should be regarded as the beneficial owner of the Korea source income, except for the following situations in which the OIV is regarded as the beneficial owner:

(1) the OIV is subject to taxation in the jurisdiction in which it resides and there was no tax avoidance purpose for establishing the OIV in that jurisdiction;

(2) the OIV is recognized as the beneficial owner provided by an applicable tax treaty; or

(3) the OIV is unable to substantiate its investors.

The Proposals clarify the above situations when the OIV should be regarded as the beneficial owner as follows.

With respect to (1) above, the Proposals have now replaced this condition with the requirement add that the OIV must be a resident of the jurisdiction of where it is established and be eligible for tax treaty benefits in accordance with the tax treaty. With respect to (2) above, the Proposals have now replaced this condition with the requirement that the OIV should be recognized as the beneficial owner under a separate provision in the tax treaty and be eligible for tax treaty benefits with respect to the applicable Korea source income in accordance with the tax treaty.

5. Extended deadline for submitting documentation relating to intra-group transactions of foreign companies

Under the current law, Korean branches of foreign companies are required to submit documents relating to their intra-group transactions, including details of intra-group transactions and allocation of head office expenses, by the due date for filing corporate income tax returns. The Proposals would extend the deadline for the submission of documentation relating to certain intra-group transactions to 6 months after the end of the relevant fiscal year.

6. Provisions for more practical application of transfer pricing rules in response to the COVID-19 pandemic

The Proposals include changes in certain provisions to enable a more practical application of the transfer pricing rules, in order to deal with challenges caused by the COVID-19 pandemic. These proposed changes reflect some of the issues raised

in the OECD's 'Guidance on the transfer pricing implications of the COVID-19 pandemic', published in December 2020. The proposed changes include the following:

- When conducting a comparability analysis to determine the arm's length price, companies can select as comparables the companies that suffered losses, depending on the economic situation, for example if there is an economic recession.
- Where a cost sharing arrangement for the development of intangibles by related parties is challenged, the tax authorities can adjust the amount allocated pursuant to the arm's length allocation of costs. The Proposals provide companies with a *force majeure* exception to this rule, (*force majeure* to include issues relating to the COVID-19 pandemic), where the *force majeure* prevents the allocation of costs in accordance with the cost sharing agreement made between the related parties.

7. Clarification on scope of adjusted taxable income and the order of non-deductibility of excess interest expenses

The Proposals clarify certain aspects of the limit on the deduction of interest expenses as follows:

- Currently under the interest expense deduction limitation rule, where an amount of net interest expenses paid to a foreign related party exceeds 30% of the adjusted taxable income, the excess amount is not deductible. The proposed rule specifies that if adjusted taxable income for a taxable year is less than zero, the adjusted taxable income will be deemed zero for the purposes of the interest expense deduction limitation rules.
- The Proposals also modify the rules for situations where the taxpayer makes separate interest payments, relating to more than a single debt instrument, at different interest rates. In such a situation, the Proposals prescribe in which order those interest payments will be non-deductible under the interest expense deduction limitation rules. In addition to the current order, i.e. that interest paid at the higher rate should be disallowed first, in cases where different interest rates exist, the proposed rule adds that if the same interest rate applies to interest payments on 2 different debt instruments, the deduction of the interest paid for the debt instrument that was borrowed on the latest date should be disallowed first. Where the borrowing dates for the relevant debt instruments are also the same, the non-deductible interest expense will be determined in proportion to the amount of each debt instrument.

8. Tightened rules against non-compliance with reporting requirements for customs valuation purposes

When importing goods from a foreign affiliate, the taxpayer is required to submit certain documentation in order to confirm the customs value of the imported goods for the purposes of the Customs Act. In order to facilitate compliance with the reporting obligations, the Proposals tighten the sanctions for non-compliance. The penalty for non-compliance or submission of false data is currently up to KRW 100 million. The Proposals allow the customs authorities to request the submission or correction of data even after a penalty for non-compliance has been imposed. In

addition, the customs authorities will be able to impose an additional penalty (of up to a maximum of KRW 200 million) for failure to submit data, with the amount of penalty dependent on the period of non-compliance.

9. New rule allowing tax deferral for merger with Special Purpose Acquisition Company

The Proposals introduce a rule allowing tax deferral in respect of a domestic merger with a Special Purpose Acquisition Company (**SPAC**). Under the current law, tax deferral (with respect to capital gains arising from the merger) is allowed only when the SPAC is the surviving company of the merger, but not when the SPAC is merged into a regular company and ceases to exist post-merger. The Proposals would allow the tax deferral to apply even in the latter case, i.e. where the SPAC disappears after the merger.

The Proposals also exempt non-surviving SPACs from certain requirements for a tax-free merger, including the requirement that the SPAC should have maintained its business for at least 1 year immediately preceding the merger.

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

The Lee & Ko Legal Newsletter is provided for general information purposes only and should not be considered as the rendering of legal advice for any specific matter. If you no longer wish to receive our newsletter service, please click here or reply to this email stating UNSUBSCRIBE in the subject line. The contents and opinions expressed in the Lee & Ko Legal Newsletter are protected by law against any unauthorized use.

More L&K Newsletters | COVID-19 Resource Center

Hanjin Building 63 Namdaemun-ro, Jung-gu Seoul 04532, Korea | Tel: +82-2-772-4000 | Fax: +82-2-772-4001/2 | www.leeko.com