NEWSLETTER

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Tax Group

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Korean Tax Law and Regulation Updates for 2023

I. Korea's current position and direction/trends within the global taxation context

Korea's latest tax reforms package was approved by the National Assembly in December 2022, with further details made clear by the Presidential Enforcement Decree which was published in January 2023. Before going into the details of the Korean tax reforms for 2023, it is important to consider the wider global context and domestic political context in which these reforms have been made, in order to understand some of the rationale underlying the reforms.

1. BEPS 2.0

Of the 15 BEPS Actions, Actions 2-15 are comfortably on track in the majority of OECD countries. The four minimum standards in particular, namely Action 5 (countering harmful tax practices), Action 6 (countering treaty abuse), Action 13 (transfer pricing documentation and country-by-country reporting), and Action 14 (improving tax dispute resolution mechanisms) are being implemented smoothly, under the peer review system of the Inclusive Framework. Action 1 however, which focuses on taxation of the digital economy, has not yet been completed, after the framework agreement on a two-pillar solution in October 2021.

Pillar One, which focuses on rules for taxing excess profits of MNEs, with a formula for allocating a certain portion of these profits to market jurisdictions, is still under discussion, although the main building blocks are now in place. The OECD has a target deadline of mid-2023 to conclude the legal texts for Pillar One, though this deadline may be ambitious.

Lee & Ko has been entrusted by the Korean government to draft the domestic rules and regulations with respect to Pillar One. In that regard, we have been working closely with the Korean Ministry of Economy and Finance to draft the Pillar One rules for domestic implementation. We will update you further on these developments.

In contrast, Pillar Two, which concerns introducing a global minimum corporate income tax rate of 15%, is much closer to implementation. The model rules for participating countries have been finalized, and in the case of Korea specifically, Pillar Two rules have been enacted in domestic legislation. In this sense, Korea is ahead of the global trend, with Korea being one of the first countries to codify Pillar Two rules in its domestic legislation.

Korea's Pillar Two rules are codified into the Korean domestic law called the "Law for the Coordination of International Tax Affairs," and is supposed to take effect from 1 January 2024. They closely follow the OECD Model Rules, containing an "Income Inclusion Rule" and "Supplementary Rules for Income Inclusion" (known as the UTPR in the OECD Model Rules).

The new rules are expected to affect both Korean MNEs and certain foreign companies with a Korean subsidiary or permanent establishment.

2. Korean domestic context

It is within this global tax context that Korea's latest package of tax reforms have been enacted. With the inauguration of President Yoon's administration, the new government's tax policy focuses on reviving economic vitality and enhancing corporate competitiveness through business-friendly and investor-friendly tax incentives, while also relieving the tax burden on low and middle income households. With high inflation and the prospect of an economic downturn in 2023, we expect a challenging domestic tax environment.

Some of the most important updates contained in the 2023 package of tax reforms are as follows.

II. Corporate Income Tax Updates (Inbound)

1. Adjustment to corporate income tax rates

For all tax brackets, the corporate income tax (**CIT**) rates have been decreased by 1%:

Tax Bracket	Pre-2023 Marginal Tax Rate (including local tax)	Post-1 Jan 2023 Marginal Tax Rate (including local tax)
Up to KRW 200 million	10% (11%)	9% (9.9%)
KRW 200 million - 20 billion	20% (22%)	19% (20.9%)
KRW 20 billion - 300 billion	22% (24.2%)	21% (23.1%)
Over KRW 300 billion	25% (27.5%)	24% (26.4%)

2. Expansion of Net Operating Loss (NOL) carryforwards

Prior to 2023, companies were able to use NOLs that arose in previous taxable years up to a limit of 60% of the tax base for a given taxable year (or 100% in the case of SMEs). As of January 2023 however, the limit has now been raised to 80% (still remaining at 100% for SMEs).

3. Reduction of securities transaction tax (STT) rates

Korea imposes a transaction tax on the transfer of securities, called STT. In 2020, a step-by-step schedule for the complete phasing out of STT was initially enacted. Under the new 2023 amendment, the step-by-step schedule has been further segmented into more steps, and thus prolonged. A comparison of the pre-2023 and post-2023 phase out schedules is as follows:

	Pre-2023 schedule		Post-1 Jan 2023 schedule			
Shares traded on	2022	2023 onwards	2022	2023	2024	2025 onwards
KOSPI KOSDAQ	0.08% 0.23%	0.00% 0.15%	0.08% 0.23%	0.05% 0.20%	0.03% 0.18%	0.00% 0.15%
Unlisted	0.43%	0.35%	0.43%	0.35%		

4. Strengthened documentation requirements to apply for tax treaty benefits and for transfer pricing

Tax treaty benefits: prior to 2023, in order to apply for a tax treaty benefit, it was necessary to submit an application form and certificate of residence to the relevant local tax office.

Post-1 January 2023 however, these documentary requirements have been strengthened as follows:

(i) The tax authorities now have the power to request further information if they consider the submitted documents to be insufficient;

(ii) Additional evidentiary documents are required, provided that the benefit being claimed via the pertinent tax treaty is 1 billion KRW (per case or cumulative claimed amount for the last year) or above, namely:

- Where the applicant is a company, proof of establishment of the company (e.g., proof of the status of directors and shareholders) and its operations (e.g. an auditor's report for the most recent three-year period).
- Where the income to which tax applies is royalties, documents substantiating the actual owner of the intangibles (e.g., license agreement and documents showing the owner of the IP and place of registration).

Transfer pricing: post 1-January 2023, books and other evidentiary documents relating to intra-group transactions must be retained at a place of business in Korea, such as the address registered with the local tax office.

5. Increased exemption thresholds for submission of related party transaction details

The number of thresholds below which there is an exemption to the requirement to submit related party transaction details have been increased, so the new thresholds as of 1 January 2023 are as follows (newly added thresholds underlined):

Document	Post-1 Jan 2023 Exemption Threshold
Statement of Cross-border Related Party Transactions (per counterparty)	■ KRW 500 million or below for tangible good transactions; or ■ KRW 100 million or below for service and intangible transactions respectively
Summarized P/L for foreign related parties (per counterparty)	■ KRW 1 billion or below for tangible good transactions; ■ KRW 200 million or below for service and intangible transactions respectively
Statement of Transfer Pricing Method (per counterparty)	■ Entire amount of foreign related party transactions: KRW 5 billion or below for tangible good transactions and KRW 1 billion or below for service and intangible transactions respectively; or ■ Per each foreign related party: KRW 1 billion or below for tangible good transactions and KRW 200 million or below for service and intangible transactions respectively

6. Additional compliance requirements for liaison offices

Previously, the 2021 tax law amendments introduced new rules requiring liaison offices of foreign companies in Korea to submit additional information on their Korean operations such as personal details of representatives, how the operating funds are sourced, information on foreign headquarters and other subsidiaries in Korea, and data on their transacting parties within Korea.

As of 2023, in addition to the foregoing compliance burden, another layer of compliance has been added with the requirement for liaison offices to submit an aggregate summary of tax invoices received from vendors, by February 10th of the year following the year in which the invoice is issued.

7. Allowing issuance of revised import VAT invoices

Prior to 2023, revised import VAT invoices were issued by the Head of the Customs Office in very limited situations only, which made it difficult for importers in Korea to reclaim input VAT.

As of 2023 however, it will be much easier for taxpayers to obtain revised import VAT invoices after they have voluntarily amended (upward) their import prices, even in expectation of an imminent customs audit. Ultimately, this revision will allow taxpayers to reclaim additional input VAT.

The only exceptions to the new rules are in situations where taxpayers fraudulently report their import prices, or repeatedly make mistakes with respect to their import prices due to gross negligence.

III. Corporate Income Tax Updates (Outbound)

1. New dividend deduction from foreign subsidiaries

Prior to 2023, dividends received from a foreign subsidiary were included in a Korean company's taxable income, and subject to CIT at the normal rates, with any double taxation relieved by a foreign tax credit. The 2023 tax reforms introduced a dividend deduction rule (aka, participation exemption), whereby 95% of dividends received from a foreign subsidiary are deducted/excluded from a Korean company's taxable income.

In order to benefit from this new rule, the Korean company must have held at least a 10% ownership interest in the foreign subsidiary, and for at least 6 months as of the dividend record date.

2. Indirect foreign tax credits: relaxation of criteria

The 2023 tax reforms relaxed the eligibility criteria for indirect foreign tax credits, as follows:

Pre-2023 criteria	Post-1 Jan 2023 criteria
■ Shareholding threshold: at least 25% of the shares or interests in a foreign subsidiary ■ Holding period: at least six months prior to the dividend declaration date (i.e., the date on which dividend payment is approved at the shareholders' meeting) of the foreign subsidiary	■ Shareholding threshold: at least 10% of the shares or interests in a foreign subsidiary ■ Holding period: at least six months prior to the dividend record date

3. Changes to CFC regime

An expansion to the CFC exception was made for foreign companies engaged in financial or insurance business that disposed of the shares in their subsidiary in the relevant taxable year. As of 2023, foreign subsidiaries engaged in financial or insurance business are eligible for a CFC exception with respect to passive income arising in the ordinary course of their financial or insurance business.

4. Tackling hybrid entities: special tax treatment for foreign flow-through entities

As of 2023, a new anti-hybrid rule has been introduced. This rule applies to investments made by domestic investors in overseas pass-through entities. Where an investment is made into such an entity, if it is treated as a tax transparent entity for the purposes of the jurisdiction in which the entity is located, it will also be treated as tax transparent for Korean tax purposes.

In order to apply for this new tax treatment, Korean taxpayers that are shareholders of the overseas pass-through entity should file an application to the relevant local tax office.

IV. Individual Income Tax Updates

1. Adjustment to individual income tax (IIT) brackets

In order to lessen the tax burden on low and middle income households, the tax base for the bottom 3 tax brackets is shifting upwards, as follows:

Tax rate (including local income tax)	Pre-2023 Tax Base	Post-1 Jan 2023 Tax Base
6% (6.6%)	Up to KRW 12 million	Up to KRW 14 million
15% (16.5%)	KRW 12 - 46 million	KRW 14 - 50 million
24% (26.4%)	KRW 46 - 88 million	KRW 50 - 88 million
35% (38.5%)	KRW 88 - 150 million	KRW 88 - 150 million
38% (41.8%)	KRW 150 - 300 million	KRW 150 - 300 million
40% (44%)	KRW 300 - 500 million	KRW 300 - 500 million
42% (46.2%)	KRW 300 million - 1 billion	KRW 300 million - 1 billion
45% (49.5%)	Over KRW 1 billion	Over KRW 1 billion

2. Extension to 19% foreigner flat rate tax

Foreigners working in Korea can opt to be taxed on their employment income at a flat rate of 19% (20.9% including local income tax), rather than the normal progressive rates of taxation. Whereas in previous years this 19% flat rate had a 5-year limitation period, as of 1 January 2023, there is now a 20-year limitation period, with no sunset provision.

In order to claim the 19% flat rate, the taxpayer must submit an application to the tax authorities when filing their annual IIT return, or to their employer at the time of their monthly payroll withholding or year-end settlement.

3. Income tax reduction for foreign engineers and researchers

Under the previous law, foreign engineers and researchers who met certain criteria were entitled to a 50% reduction of their IIT for a 5-year period (or in certain cases, a 70% reduction for the first 3 years, and a 50% reduction for the subsequent 2 years). Applicable to income earned on or after 1 January 2023, the 5-year tax reduction period has now been extended to 10 years.

4. Virtual assets: 2 year postponement of taxation

Virtual asset taxation was due to take effect from 1 January 2023, but this has been pushed back to 1 January 2025. As of that date, gains realized upon transfer, loan, or withdrawal of virtual assets will be subject to tax, and classified on the tax return as "other income." Creating or acquiring virtual assets (e.g. Bitcoin mining) will not be a taxable event, and VAT is unlikely to apply to virtual asset transactions.

For resident individuals, worldwide virtual asset gains over KRW 2.5 million will be taxed at a flat rate of 22%. For non-resident individuals or foreign companies without a Korean permanent establishment, Korean-source virtual asset gains will be taxed at the lower of: (i) 22% x gain; or (ii) 11% x transfer price. As for domestic companies, it is generally accepted that their virtual asset gains are already taxable according to general taxation principles.

5. Obligation to submit virtual asset transaction details

Under the Corporate Income Tax Act, virtual asset service providers (**VASPs**) are now required to submit data relating to virtual asset transactions to the NTS. This update will affect the same VASPs that are subject to AML and anti-terrorist financing reporting obligations. Effective from 1 January 2023, VASPs now also have to submit transaction details within 2 months of the end of every quarter.

6. **Tax exemption on interest and capital gains derived from government bonds by non-residents and foreign companies without a Korean PE**

Effective from 1 January 2023, interest and capital gains received from Korean government bonds and monetary stabilization bonds by non-residents and foreign companies without a Korean PE, are now exempt from tax in Korea. This amendment expands the scope of the exemption from qualified bonds denominated in foreign currency (interest and gains from which were already exempted, even prior to 2023) to also include KRW bonds.

To invest in these bonds, the non-resident or foreign company will have to open an account directly with the relevant government institution. To benefit from the tax exemption, it will be necessary to file an application at the relevant district tax office.

If you have any questions or comments regarding this Tax Alert, please do not hesitate to contact one of the tax experts at Lee & Ko.

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

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