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PROPOSED AMENDMENTS TO THE KOREAN TAX LAWS FOR 2022

On July 21, 2022, the Ministry of Economy and Finance (MOEF) released its proposed amendments to the Korean tax laws for 2022. The key policy initiatives announced in the proposals are aimed at: (i) stimulating the economy through reasonable modifications to the tax law; (ii) stabilizing citizens' livelihoods by reducing tax burdens; (iii) strengthening the tax system by improving fiscal sustainability and tax fairness; and (iv) creating a taxpayer-friendly environment by increasing taxpayer convenience. The MOEF projects that the tax revenue will drop by approximately KRW 13.1 trillion over the next five years as a result of the revisions. Revenue from income taxes and corporate taxes are expected to decrease by KRW 2.5 trillion and KRW 6.8 trillion respectively, accounting for 71% of the total decrease in revenue anticipated from the tax reforms. If the proposals are approved at the National Assembly, the amendments will become effective as of January 1, 2023.

Provided below is a summary of the major reforms proposed which may have an impact on foreign businesses with presence in Korea.

I. Adjustments to the Corporate Income Tax Rates and Tax Brackets

Under the current tax laws, the corporate income tax rates under four tax brackets range from 10 – 25%. The proposal reduces the top marginal tax rate from 25% to 22% and applies a special tax rate of 10% for small and midsize enterprises (SMEs) and medium-scale companies in an effort to relieve the corporate income tax burden and provide support for investment and job creation.

The adjustments proposed are as follows:

Taxable Income (KRW)	Marginal Tax Rate
500 million or less	20% (10% for qualifying SMEs and medium-scale companies)
500 million – 20 billion	20%
More than 20 billion	22%

The special tax rate of 10% does not apply to SMEs and medium-scale companies

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if: (i) the controlling shareholder owns more than 50% of the total shares in the company; and (ii) the company's primary business activity constitutes real estate rental business or if the real estate rental income, interest income and dividend income account for 50% or more of the company's total revenue.

The proposed changes will come into effect for tax years starting from January 1, 2023 onwards.

II. Introduction of Dividend Received Deduction (DRD) rules

Under the current tax rules, a Korean company receiving dividends from foreign subsidiaries are required to include such dividend income in its taxable income and claim a foreign tax credit on foreign taxes paid. Under the proposed amendments, 95% of certain qualifying dividends received by a Korean company from a foreign company in which it has held at least 10% of the outstanding shares for a continuous period of six months or more from the dividend record date can be excluded from the company's taxable income.

The scope of dividends eligible for deduction includes dividends from profits, distributions from earnings reserves and deemed dividends. Excluded from the scope are deemed dividends from undistributed earnings of controlled foreign corporations, deemed dividends from hybrid financial instruments and indirect investment companies (other than private equity funds for institutional investors).

The new rules will come into effect for dividends received from January 1, 2023 onwards.

III. Increased Limitation for Deduction on Losses Carried Forward

Under the proposed rules, the limit on deduction for losses carried forward will increase from the current limitation of 60% of taxable income to 80%. This amendment will come into effect for tax years staring from January 1, 2023 onwards.

IV. Flat Tax Rate for Foreigners

Under the current tax law, foreign expatriate employees are eligible for a flat tax rate of 19% on income earned in Korea for the first five years of their employment in Korea. As a means to incentivize foreign investment, the amendment proposes to abolish the five-year term limit. This concession rate applies to foreigners who are currently benefiting from the lower rate as well as those who have applied the rate in the past.

The changes are applicable to income earned from January 1, 2023 onwards.

V. Postponed Introduction of Tax on Financial Investment Income

The proposal delays the introduction of a new category of tax on financial investment income, which was set to come into effect as of January 1, 2023, for a period of two years. The tax would apply to income derived from stocks, bonds, investment contracts securities, derivative-linked securities and derivative products.

The amendment will come into effect as of January 1, 2025.

VI. Adjustments to Securities Transactions Tax Rates

The securities transactions rates, which were scheduled to decrease in 2023, have been adjusted under the proposal as follows:

	Current		Proposed		
	2022	2023	2022	2023-2024	2025
KOSPI	0.23%	0.15%	0.23%	0.20%	0.15%
KOSDAQ	0.23%	0.15%	0.23%	0.20%	0.15%

NOTE: KOSPI rates are inclusive of 0.15% in agriculture and fishery surtax

VII. Postponed Introduction of Tax on Virtual Assets

Under the current tax law, income derived from the transfer or loan of virtual assets were scheduled to be subject to taxation in the other income category beginning on January 1, 2023. The proposal delays the introduction of the new rules until January 1, 2025.

VIII. Tax Exemption on Interest and Capital Gains from Government Bonds and Currency Stabilization Bonds for Non-Residents and Foreign Companies

The proposal introduces a withholding tax exemption for non-residents and foreign companies without any place of business in Korea on Korean source interest income and capital gains derived from government bonds or currency stabilization bonds. Such investments may be made directly by opening an account with a domestic custodial institution or indirectly through a qualified foreign financial institution in Korea. In order to benefit from the tax exemption, an application should be filed with the relevant tax office with jurisdiction. This exemption does not apply to Korean tax residents or domestic corporations that invest in such bonds through overseas public collective investment vehicles.

The new rules will come into effect as of January 1, 2023.

IX. Introduction of Global Minimum Tax

The proposal introduces the global minimum tax rules, which are consistent with the Global Anti-Base Erosion (GloBE) Model Rules (Pillar Two) set out within the OECD Inclusive Framework and published by the OECD on December 20, 2021. These new rules are intended to have large multinational enterprise (MNE) groups pay a minimum level of tax on the income arising in each of the jurisdictions in which they operate. Where the effective tax rate is below 15 percent, the proposed rules will impose a top-up tax.

The new rules apply to constituent entities of an MNE group with consolidated revenues of at least EUR 750 million in at least two of the four prior fiscal years. Government entities, international organizations, nonprofit organizations, pension funds, as well as investment funds or real estate investment vehicles that are ultimate parent entities are excluded.

The primary rule is to apply the Income Inclusion Rule (IIR), which requires the ultimate parent entity at the top of the ownership chain to be liable for the top-up tax of all low-tax constituent entities in proportion to its ownership interest. If the top-up tax cannot be levied on the ultimate parent entity, the IIR applies to the next intermediate parent entity. A partially-owned parent entity that has an ownership interest in another constituent entity of the same group and has more than 20% of ownership interests held directly or indirectly by non-group members may be subject to tax on its allocable share of the top-up tax.

The jurisdictional top-up tax is computed in accordance with the following formula:

Top-Up Tax = (Minimum Rate – Effective Tax Rate) * (Net GloBE Income – Substance based Income Exclusion) + Additional Current Top up Tax – Qualified Domestic Top up Tax

The effective tax rate is equal to the sum of the adjusted covered taxes of each constituent entity located in the jurisdiction divided by the net GloBE income of the jurisdiction in the fiscal year. Adjusted covered taxes are equal to the current tax expense accrued in its financial accounting net income or loss with respect to covered taxes adjusted by total deferred tax adjustment amounts. Net GloBE income is the excess of GloBE income over the GloBE losses of all constituent entities whereby a constituent entity's financial accounting net income or loss is adjusted for certain items, such as net taxes expenses, to arrive at that entity's GloBE income or loss.

A parent entity's allocable share of the top-up tax to a low-taxed constituent entity is an amount equal to the top-up tax of the low-taxed constituent entity multiplied by the parent entity's inclusion ration for the low-taxed constituent entity for the fiscal year. The parent entity's inclusion ratio is the ratio of (a) the GloBE Income of the low-taxed constituent entity for the fiscal year, reduced by the amount of such income attributable to ownership interests held by other owners, to (b) the GloBE Income of the low-taxed constituent entity for the fiscal year.

To the extent the low-tax constituent entity is not subject to an IIR that is implemented in accordance with the GloBE rules under the laws of another jurisdiction, the Undertaxed Payments rule (UTPR) applies. The UTPR top-up tax amount allocated to Korea is determined by multiplying the Total UTPR Top-up tax amount by the jurisdiction's UTPR percentage. The UTPR percentage is based on the following formula:

(50% * the ratio of the number of employees in the jurisdiction over the number of employees in all UTPR jurisdictions) + (50% * ratio of the total value of tangible assets in the jurisdictions over total value of all tangible assets in all UTPR jurisdictions)

A Korean constituent entity is required to file a GloBE Information Return within 15 months from the end of the fiscal year. If a foreign constituent entity of an MNE Group has filed a GloBE Information Return with the tax administration of the jurisdiction where it is located, the Korean constituent entity is discharged from the obligation to file separately. However, the Korean tax authorities must be notified of the foreign constituent entity within 15 months.

The new rules apply for fiscal years beginning on or after January 1, 2024.

X. Broadened Scope for Issuance of Corrected Import Tax Invoices

Under the current VAT law, corrected import tax invoices are only issued if the correction relates to minor mistakes/errors, or where the importer is able to demonstrate that the importer is not at fault. According to the proposals, corrected import tax invoices may be issued in all instances, with the exception of situations involving legal violations or gross negligence.

This change will come into effect as of January 1, 2023.

XI. Tightened Treaty Exemption Requirements for Non-Residents and Foreign Companies

The current requirements for non-residents and foreign companies to apply for exemption of taxes under a relevant treaty are to submit an Application for Tax Exemption with the payor of income or the withholding agent, along with a tax residency certificate of the beneficial owner of income. Under the revisions proposed, additional documentation would need to be submitted, including documentation relating to the incorporation of the foreign corporation as well as documentation on Korean-source income. Further, the revised law grants the tax office authority to make a decision or correction on the submission in the event the application does not meet the tax exemption requirements or if the contents of the submission are inaccurate. The tax office may also request additional information in the event the submission is incomplete, making it impossible to determine whether the requirements for tax exemption have been met. Separately, the payor of income may request information from the non-resident or foreign corporation.

This measure comes into effect for applications filed from January 1, 2023.

XII. Requirement to Submit Input Tax Information for Liaison Offices

Under the current tax law, liaison offices of foreign companies are required to submit basic information on the liaison office, status of its foreign company and branch office in Korea, as well as transactions within Korea. Under the proposed revisions, a summary of the input VAT exemption invoices per supplier is also required to be submitted by February 10 of the following year.

This new requirement applies to supply of goods or services received from January 1, 2023 onwards.

XIII. Broadened Scope of Exemption from Requirement to Submit Cross-Border Transaction Documents

Taxpayers engaging in cross-border transactions with related parties are generally required to submit certain transfer-pricing related documents, such as: (i) an international transaction statement for each foreign related party; (ii) a summary income statement of each foreign related party; and (iii) a report on the transfer pricing methodology applied. Taxpayers that meet the below requirements are not required to submit certain documents, as follows:

- The international transactions statement is not required to be filed with respect to taxpayers that submit master files, local files and CbC reports. The proposed amendments expands the scope of exemption to include instances: (i) where transactions with foreign related parties involving the supply of goods is less than KRW 500 million in total; (ii) where transactions with foreign related parties involving the supply of services is less than KRW 100 million in total; and (iii) where transactions with foreign related parties involving the supply of intangible assets is less than KRW 100 million in total.
- Under the current law, the summary income statement is not required to be filed in instances where related party transactions involving the supply of goods is less than KRW 1 billion or transactions involving the supply of services is less than KRW 200 million. The proposal broadens the scope of exemption to include related party transactions involving intangible assets of less than KRW 200 million.
- The report on transfer pricing methodology is not required to be filed if a taxpayer’s cross-border transactions with related parties involving the supply of goods is, in total, less than KRW 5 billion or

the supply of services is less than KRW 1 billion. This exemption also applies in instances where the transactions with each related party is less than KRW 1 billion for supply of goods or KRW 200 million for the supply of services. The proposed amendment applies this waiver if the supply of intangible assets is less than KRW 1 billion in total or less than KRW 200 million per related party.

XIV. Requirement to Retain Transfer Pricing-related Documentation within Korea

The current document retention requirements is for taxpayers to document and retain all records and evidentiary documents on all transactions relevant to the tax law. The new requirement under the proposed rules requires transfer pricing-related documents to be retained within Korea. The scope of documents includes all documents that the tax authorities may request from a taxpayer in its application of the transfer pricing regime, such as organizational charts, work allocation tables, and copies of asset purchase and sale agreements. The new rule specifies the location to be in the place of tax payment such as the place of residence or place of business, or at a location designated by the tax authority.

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We provide tailored comprehensive and practical solutions on the basis of our vast expertise and experience. For questions or inquiries on the foregoing, please feel free to contact us.