

Korean Tax Brief

Update on Current Issues and Trends



2019 Amendment Tax Law and Enforcement Decree

I. Overview

The 2019 tax law amendments that were passed in the National Assembly includes various changes in tax laws aiming to revitalize the economy, support innovative growth, enhance economic and social tolerance and equality, and to promote rationalization of the tax system and expansion of the tax collection period. After the pre-announcement of legislation period ('20.1.6 ~ '20.1.28), on February 4, 2020, the cabinet council of the Korean government has approved 20 amendments to the Enforcement Decrees of tax laws to outline specific provisions to the 2019 tax law revisions. The amendments to the Enforcement Decrees will be officially announced and effectuated during February 2020.

II. Major amendments

The major tax law amendments and accompanying Enforcement Decree of the tax law are as follows

◆ Corporate Income Tax Law

(1) Changes to the Dividend Received Deduction (Corporate Income Tax Law §18-2, §18-3)

Under current regulations, a portion of dividends domestic companies and holding companies receive from its domestic subsidiaries is deemed non-taxable (Dividend Received Deduction, "DRD") for which the rate of deduction is dependent on its shareholding in the domestic subsidiary. The amendment to the tax law aligns the shareholding requirements to match with the Monopoly Regulation and Fair Trades Act of Korea where 'Excess of' is changed to 'More than or equal to' and 'Less than or equal to' is changed to 'Less than' (refer to the table below). The amendments to the tax law will take into effect from dividends received after January 1, 2020.

Investor	Investee	Shareholding (current)	Shareholding (revised)	DRD
Holding company	Listed company	Excess of 40%	More than or equal to 40%	100%
		Excess of 30% less than or equal to 40%	More than or equal to 30% less than 40%	90%
		Less than more equal to 30%	Less than 30%	80%
	Other	Excess of 80%	More than or equal to 80%	100%
		Excess of 50% less than or equal to 80%	More than or equal to 50% less than 80%	90%
		Less than or equal to 50%	Less than 50%	80%
Non-Holding company	Listed company	100%	100%	100%
		Excess of 30% less than 100%	More than or equal to 30% less than 100%	50%
		Less than or equal to 30%	Less than 30%	30%
	Other	100%	100%	100%
		Excess of 50% less than 100%	More than or equal to 50% less than 100%	50%
		Less than or equal to 50%	Less than 50%	30%

(2) Revised Method of Deducting Donation Carryover (Corporate Income Tax Law §24, Enforcement Decree of the Individual Income Tax Law §79)

Under current regulations, the order in which donations were deducted from taxable income was to first deduct donations made during the relevant tax period, then to deduct any donations carried over from previous periods up to the tax limit (non-deductible amount is carried over for 10 years). To promote donations from corporations and individuals, the amended tax laws have revised the order in which donations are deducted wherein carried-over donations are deducted from taxable income before donations made during the relevant tax period up to the tax limit. The amended tax laws and Enforcement Decree will take into effect from tax returns filed on or after January 1, 2020.

(3) Increase tax limit for entertainment expenses (Corporate Income Tax Law §25-4, Individual Income Tax Law §35)

Under current regulations, the tax deductible limit for entertainment expenses is calculated as the sum of the base limit of KRW 12 million (KRW 24 million for Small and Medium Enterprises) and additional limit based on total revenues. To reduce the tax burden of Small and Medium Enterprises and to promote economic growth, the amended tax laws increase the base limit for Small and Medium Enterprises to KRW 36 million, and increase the additional limit to 0.3% (up from 0.2%) of revenues for revenues under KRW 10 billion and 0.2% (up from 0.1%) of revenues for revenues in excess of KRW 10 billion but under KRW 50 billion. The amended tax laws will take into effect from tax years beginning on or after January 1, 2020.

(4) Reduced Burden of Capitalization for Small Repair Costs (Enforcement Decree of the Corporate Income Tax Law §31, Enforcement Decree of the Individual Income Tax Law §67)

Under current regulations, repair costs incurred to extend the useful life or increase the value of an asset are normally included within the taxable base of the asset and depreciated over its useful life, but as an exception, if the repair costs for an asset does not exceed KRW 3 million, the repair costs are deemed revenue expenditure and is fully tax deductible in the year it is incurred. In consideration of inflation etc., the amended Enforcement Decree increases the KRW 3 million threshold to KRW 6 million which will take into effect from tax years beginning on or after January 1, 2020.

(5) Reduced Burden of Maintaining Operation Records for Business Use Passenger Vehicles (Enforcement Decree of the Corporate Income Tax Law §50-2⑦,

Enforcement Decree of the Individual Income Tax Law §78-3⑥)

Under current regulations, expenses in relation to business use passenger vehicles (depreciation, lease(rent), gas, etc.) that were either acquired or leased(rented) were only tax deductible up to the portion incurred in relation to business purpose use as substantiated by maintaining operation records. However, if such expenses were less than KRW 10 million for the tax year (per vehicle basis), then the full amount was tax deductible without the requirement to maintain an operation record. In consideration of inflation etc., the amended Enforcement Decree increases the KRW 10 million threshold to KRW 15 million, and will take into effect from tax years beginning on or after January 1, 2020

(6) Improve Taxation of Domestic Source Income Paid for Use of Patents Not Registered in Korea (Individual Income Tax Law §119, §156①, Corporate Income Tax Law §93, §98①)

In improving taxation of royalty payments for the use of patents not registered in Korea, the amended tax laws clarify the definition of 'other like property or rights' (as stipulated under applicable tax treaties that employ the 'paid for the use of' principle¹) to include the use of patents not registered in Korea for processing or manufacturing in Korea. In addition, in improving taxation of payouts for patent infringements not registered in Korea, the amended tax law includes payouts for patent infringements for which the patent is registered in certain countries² (not registered in Korea) within the definition of domestic sourced other income of foreign entities. In general, payment of domestic source other income to foreign entities is subject to 20% withholding tax Korea. However, for patent infringement payouts above, the withholding tax rate has been reduced to 15% to match the reduced withholding tax rates applicable for royalty payments under applicable tax treaties. Both amended tax laws will take into effect for royalty payments and payouts for infringement of patents paid on or after January 1, 2020.

The amendments above can be interpreted as an attempt by the Korean government to tax royalty payments paid to US entities for the use of patents not registered in Korea. Historically, such payments (including payouts for infringement of such patents) have been determined by the supreme courts of Korea to not be taxable in Korea under the Korea-US tax treaty, a restriction which the Korean government hopes to circumvent by clarifying that royalty

1 Namely the Korea-US Tax Treaty

2 Countries that have a tax treaty with Korea that employs the 'paid for the use of' principle; Namely the US

payments for the use of patents not registered in Korea to be within the scope of use of other like property or rights as stipulated under the tax treaty, and payouts for infringement of patents not registered in Korea to be within the scope of domestic sourced other income (thus allowing such payments to be taxable in Korea under the Korea-US tax treaty). It is currently unclear how the amended tax laws will affect royalty payments to the US and require close monitoring on how the supreme courts of Korea interpret the revisions in conjunction with the Korea-US tax treaty.

(7) Expansion of Tax-Deductible Expenses of Korean Permanent Establishments (Enforcement Decree of the Corporate Income Tax Law §130②, Enforcement Decree of the Individual Income Tax Law §181-2②)

Under current regulations, in determining taxable income of the Korean Permanent Establishment of a foreign company, head-office expenses recharged to the Korean Permanent Establishment were tax deductible only up to the extent that such expenses were at arm's length, incurred in accordance with an agreement, and actually paid and settled by the Korean Permanent Establishment. Furthermore, interest expenses (excluding interest incurred at the level of the Korean Permanent Establishment) incurred at the level of the head-office and recharged to the Korean Permanent Establishment were not tax deductible. The amendment to the Enforcement Decree expands the tax deductibility of head-office expenses by allowing tax deduction of such expenses (including interest expense incurred at the level of the head-office) without the payment requirement so long as such expenses were reasonably recharged in relation to Korean sourced revenues. The amended Enforcement Decree will take into effect from tax years beginning on or after January 1, 2020. However, tax deductibility of interest expense incurred at the level of the head-office will only be effective if the relevant tax treaty is effectuated or revised to allow such after the amended Enforcement Decree is placed into effect.

(8) Expansion of Taxable Business Income of Korean Permanent Establishments (Enforcement Decree of the Corporate Income Tax Law §132③, Enforcement Decree of the Individual Income Tax Law §179③)

Under current regulations, business income generated overseas that were attributable to a Korean Permanent Establishment was only deemed Korean-sourced and taxable in Korea if the type of such business income was specifically enumerated in the tax law (investment in foreign securities or lending money to a foreign entity, lease, granting a permit to use, transfer or exchange of assets or rights overseas, and issuance, acquisition, transfer, or exchange of stocks, bonds, and other assets overseas).

The amendment to the Enforcement Decree removes the requirement that such business income be enumerated in the tax law, effectively expanding the scope of overseas generated business income taxable in Korea to all types of business income attributable to a Korean Permanent Establishment. The amendment will take into effect from tax years beginning on or after January 1, 2020.



◆ Individual Income Tax Law

(1) Aggregate Gains and Losses from Disposal of Domestic Shares and Foreign Shares (Individual Income Tax Law §94)

Under current regulations, capital gains from disposal of shares in domestic companies (limited to unlisted shares or disposal of listed shares by the majority shareholder) are taxed separately from capital gains from disposal of shares in foreign companies. Under the amended tax laws, capital gains and losses from disposal of domestic shares and foreign shares are to be aggregated allowing capital losses from disposal of domestic or foreign shares to be offset against gains from disposal of the other, and KRW 2.5 million of basic deduction are to be applied on the aggregate income. The amended tax law will take into effect for disposal of shares on or after January 1, 2020.

(2) Reduce Maximum Limit for Directors' Retirement Income (Individual Income Tax Law §22)

Under current regulations, the maximum limit for directors' retirement income was calculated as the three-year average salary * 1/10 * tenure after 2012 * multiplier (3) where any severance payment in excess of the limit was treated as employment income which is taxed at a higher rate compared to retirement income. The amended tax law reduces the limit by revising the multiplier down to (2), but in consideration of retirement income attributable to periods before the amendment, the revised multiplier will only be applicable for retirement income attributable to periods after amendment. The amended tax law will take into effect for severance payments after January 1, 2020.

(3) Reduced Burden of Tax-Deductible Expense Requirements Relating to Personal Service Income of Non-residents (Enforcement Decree of the Individual Income Tax Law §179⑦, Enforcement Decree of the Corporate Income Tax Law §132⑦)

Under current regulations, in calculating Korean-sourced income of foreign entities generated from provision of personal services, air fare, accommodation, or meal expenses incurred in relation to the provision of personal services were deductible against Korean-sourced personal service revenues provided that the Korean entity receiving personal services paid such expenses directly to the air carriers, accommodation business operators, or restaurant business operators. The amendment to the Enforcement Decree reduces the burden of claiming such deduction by including instances where such expenses were paid to the business operators by the service provider of the personal service provided that the payment can be substantiated as document evidence. The amendment will take into effect for personal service fees paid after the amended Enforcement Decree is effectuated.

(4) Align Definition of Controlling Shareholder with Basic Law for National Tax (Enforcement Decree of the Individual Income Tax Law §158①)

Under current regulations, 'Controlling Shareholders' subject to capital gains tax upon disposition of 50% or more shares in a real estate rich company (50% or more total asset value derived from real estate or shareholding in another real estate rich company) are defined as shareholders that hold 50% or more of the real estate rich company together with their related parties. The amendment to the Enforcement Decree aligns the definition of 'Controlling Shareholders' by revising the shareholding requirement to be in excess of 50% as opposed to the current equal to more than 50% requirement. The amendment will take into effect for disposal of shareholding in real estate rich companies after the amended Enforcement Decree is effectuated.



◆ Enforcement Decree of the Value-Added Tax Law

(1) Reduce Penalty for Taxpayer Having Multiple Business Places (Value-Added Tax Law §60②)

Under current regulations, in case where a taxpayer having multiple business places issues VAT invoice in the name of a business place whereas actual goods and services were provided by a different business place, a 2% penalty for non-issuance of VAT invoice was imposed on the value of supply. In consideration of the minor nature of infringement, the amended tax law reduces the penalty burden for taxpayers by reducing the penalty to 1% on the value of supply. The amended tax law will take into effect for goods and services supplied on or after January 1, 2020.

(2) Reduce Duplicated Penalty (Value-Added Tax Law §60③)

Under current regulations, penalties for the issuance or receipt of an overstated VAT invoice (2% on the value of supply) and penalties for issuance of an incorrect VAT invoice (1% on the value of supply) could concurrently be imposed. In reducing imposition of duplicate penalties, the amended tax law has clarified that penalties for issuance of an incorrect VAT invoice (1%) is not to be applied for transactions that are subject to penalties for the issuance or receipt of an overstated VAT invoice (2%). The amended tax law will take into effect for goods and services supplied on or after January 1, 2020.

(3) Clarify Scope of Non-deductible Input VAT (Value-Added Tax Law §39①)

Under current tax laws, in cases where mandatory fields in a VAT invoice (business registration number of the supplier and customer, value of supply, VAT, date of issuance) is erroneous, the relevant input VAT is not deductible. In alleviating challenges between the taxpayer and the Korean tax authorities and to reduce burden of tax for taxpayers, the amended tax law clarifies that in case the value of supply is erroneous, input VAT in relation to the difference between the erroneous and actual value of supply is non-deductible. The amended tax law will take into effect for goods and services supplied on or after January 1, 2020.

(4) Add Investment Advisory Service Provided to Non-residents to be Subject to Zero-rate VAT (Enforcement Decree of the Value-Added Tax Law §33②)

Under current regulations, subject to the rule of reciprocity, certain foreign currency earning services (including professional and business support services) provided to

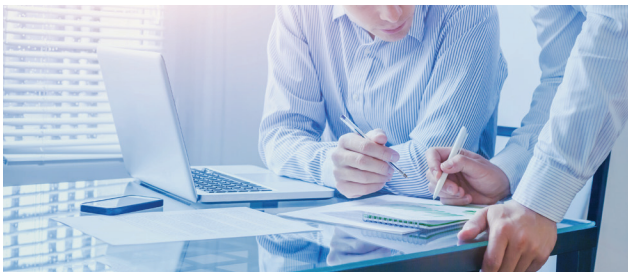
non-residents and foreign corporations without a permanent establishment in Korea were subject to zero-rate VAT. In providing equal tax treatment for services of similar nature, the amended tax law adds investment advisory services to the list of foreign currency earning services subject to zero-rate VAT. The amended tax law will take into effect for services rendered on or after July 1, 2020.

(5) Approve Issuance of VAT Tax Invoice by the Surviving Company Before Registration of Merger (Enforcement Decree of the Value-Added Tax Law §69¹⁹ Newly enacted)

Under current regulations and certain conditions, the VAT tax invoice can be issued by entities that are not the actual providers of goods and services. To align with accounting practices and to alleviate the administrative burden from tax compliance for mergers, the amendment to the Enforcement Decree expands the condition to include cases where the surviving entity from a merger issues and receives VAT tax invoices on behalf of the merging entity during the period the two entities are merged, and the merger is registered. The amendment will take into effect for goods and services supplied after the amended Enforcement Decree is effectuated.

(6) Expand Applicable Period for Bad Debt Deduction (Enforcement Decree of the Value-Added Tax Law §87²⁰)

Businesses that wrote off a portion or full amount of accounts receivable (including VAT) as irrecoverable in relation to provision of VAT leviable goods or services are able to credit the irrecoverable VAT against output VAT in the period the account receivable was determined to be irrecoverable provided that the accounts receivable was written off in accordance with the requirement stipulated under the Enforcement Decree. Under current regulations, the bad debt amount needs to be fixed and determined to be irrecoverable within 5 years from the date the goods and services were provided, and the amendment to the Enforcement Decree expands the applicable period to 10 years to alleviate the tax burden of taxpayers. The amendment will take into effect for bad debts determined to be irrecoverable after the amended Enforcement Decree is effectuated.



◆ Enforcement Decree of the International Tax Coordination Law

(1) Refine Duplicate Data Submission in relation to International Transactions (Enforcement Decree of the International Tax Coordination Law §7, §21-2 Newly Enacted)

To reduce the tax compliance burden of taxpayers by eliminating unnecessary data submission requirements, the 2019 tax law amendments exempted companies that submit local and master files in accordance with the Enforcement Decree from submission requirement of the Statement of International Transactions. The amendment to the Enforcement Decree avoids duplicate data submissions by exempting companies that submit local and master files from submission requirement of the Report on the Method of Computing Transfer Price and defines the process in which the submission requirement can be exempt. The amendment will take into effect from tax years beginning on or after January 1, 2020.

(2) Increase Penalties Related to Submission of International Transaction Data (Enforcement Decree of the International Tax Coordination Law §51²¹)

Current regulations define the amount of fines to be imposed for non-reporting or misreporting of each type of statement that is required to be submitted by taxpayers in relation to international transaction. The amendment to the Enforcement Decree introduces imposition of additional fines in the same amount of the original fine every 30 days after the original due date up to a maximum accumulated fine of KRW 200 million to reinforce the obligation to submit international transaction data. The amendment will take into effect from tax years beginning on or after January 1, 2020.

(3) Rationalize Burden of Proof for Diverted Transaction (International Tax Coordination Law §2-2⁴·⁵, Enforcement Decree of the International Tax Coordination Law §3-2 Newly enacted)

Under current regulations, in cases where the International Tax Coordination Law and tax treaty benefits are abused by way of diverting international transactions, the transaction can be deemed to have occurred directly (without diversion) in consideration of its economic substance in applying regulations under the International Tax Coordination Law and the applicable tax treaty. However, the above treatment requires that the Korean tax authorities are able to substantiate that 'the taxpayer's activities were an attempt at tax evasion by diverting international transactions without reasonable business purposes for which the tax authorities

have thus far had difficulty. Under the amended tax laws and accompanying amendments to the Enforcement Decree, in reducing the burden of proof for the tax authorities, diverted international transactions resulting in a decrease of 50% or more in Korean tax liabilities are automatically deemed to be an abuse of the regulations under the International Tax Coordination Law and tax treaties (excluding cases where the reduction in Korean tax is less than KRW 100 million or if the total value of diverted transactions is less than KRW 1 billion) where the substance over form tax principle is applied unless the taxpayer is able to demonstrate that the diverted transaction was not an attempt at tax evasion which can be substantiated by reasonable business purpose, etc. The amendment will take effect from tax years beginning on or after January 1, 2020.

(4) Adopt Simplified Transfer Pricing for Low Value-Adding Intra-Group Services (Enforcement Decree of the International Tax Coordination Law §6-2)

In rationalizing the transfer pricing method for low value-adding intra-group services, the amended Enforcement Decree has adopted simplified transfer pricing where a 5% mark-up for such services is deemed at arm's length. Low value-adding intra-group services is defined as accounting, auditing, legal advisory, human resource management, etc. that are of supportive nature and not part of the core business. Furthermore, such services should ① not require the use of nor lead to the creation of unique and valuable intangibles, ② not involve the assumption or control of significant risk by the service provider, ③ not be rendered to unrelated customers, ④ not be related to research and development services; manufacturing and production services; purchasing activities of raw materials; sales, marketing and distribution activities; insurance and reinsurance; nor extraction, exploration, or processing of natural resources. Taxpayers adopting the simplified transfer pricing for low value-adding intra-group services are required to maintain documents substantiating that such services are low value-adding services. However, if the total value of low value-adding services by the taxpayer exceeds the threshold as prescribed under the Enforcement Ordinance, the simplified transfer pricing cannot be elected. The amended Enforcement Decree will take into effect for tax periods beginning on or after January 1, 2020.

◆ Tax Incentive Limitation Law

(1) Temporary Increase in Tax Credit for Investment in Production Improving Facilities (Tax Incentive Limitation Law §25)

In revitalizing the economy and supporting innovative businesses, the amended tax laws temporarily increases

tax credits for investments in facilities that increase production and clarifies that smart factories that manage to improve production based on data to be within the scope of facilities that improve production and automation subject to investment tax credits. Under the amended tax laws, investments in such facilities during 2020 by large corporations, medium enterprises, and small enterprises are subject to 2%, 5%, 10% (up from 1%, 3%, 7%) tax credit, respectively, and for 2021, 1%, 5%, and 10%, respectively. The amended tax laws will take into effect for investments on or after January 1, 2020.

(2) Clarify Assets Subject to Investment Tax Credit (Enforcement Decree of the Tax Incentive Limitation Law §4②)

In promoting tax equality, the amended Enforcement Decree disallows claiming investment tax credits for investment in assets that were instantly written off (in accordance with §67 of the Enforcement Decree of the Individual Income Tax Law and §31 of the Enforcement Decree of the Corporate Income Tax Law).

◆ Basic Law for National Tax

(1) Allow Taxpayer to File Amended Tax Return that was originally filed after Due Date (Basic Law for National Tax §45, §45-2)

Under current regulations, amendments to tax returns could only be filed if the original tax return was filed within the statutory deadline. To provide taxpayers an opportunity to self-correct, the amended tax laws removes the limitation, allowing taxpayers who have filed their tax returns after the original due date to file amended returns. The amended tax laws will take into effect for amended tax returns filed on or after January 1, 2020.

(2) Adjust Exemption Rate of Non-Filing Penalty upon Filing Tax Return After Due Date (Basic Law for National Tax §48②)

Under current regulations, 50% and 20% of non-filing penalties could be exempt if tax returns were filed within 1 month and within 1~6 months, respectively, after the statutory due date. To reduce the tax burden of taxpayers and to incentivize early self-correction, the exemption rate applicable for filing the returns within 1~6 months after the statutory due date has been further stratified where late filing within 1~3 months is entitled to 30% exemption and late filing within 3~6 months is entitled to 20% exemption of non-filing penalties. The amended tax law will take into effect for tax returns that are filed after the statutory due date on or after January 1, 2020.

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