Samil Commentary
Korean Tax Update

March 31, 2017

MOSF Releases its Guidance on the CbCR Requirements

The amended Law for Coordination of International Tax Affairs (effective December 20, 2016) and the amended Presidential Decree of the Law (effective February 7, 2017) implements country-by-country reporting (CbCR) requirement in line with Korea's commitment to adopt the standards under Action 13 of the BEPS project. Under the amended laws, the Korean ultimate parent company, etc. of a multinational group whose consolidated revenue exceeds KRW1 trillion during the preceding fiscal year is required to file the CbCR within twelve months from the end of the month in which the fiscal year end belongs (e.g., by January 2, 2018 in case of the taxpayer having a fiscal year ending December 31, 2016 because the original due date, that is, December 31, 2017 is Sunday and January 1, 2018 is a national holiday). The CbCR must include information on a multinational group's revenue in each country, profit or loss before income tax, etc.

As delegated by the amended laws to set forth details on the CbCR requirements, the Ministry of Strategy and Finance ("MOSF") released its guidance, titled 'Notice 2017-5, CbCR Filing Obligators and Scope of Covered Entities' on March 21, 2017. According to the guidance, the Korean ultimate parent company and the taxpayers for which the ultimate controlling shareholder is established in a foreign country is required to submit the application for the information concerning the CbCR filing obligator to the Korean tax authority within six months from the end of the month in which the fiscal year end belongs (e.g. by June 30, 2017 for the taxpayers having a fiscal year ending December 31, 2016). Other key points of the Ministry's guidance include:

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Filing obligator

- In case the ultimate parent company is a domestic company or a resident of Korea, the filing obligator is the domestic parent company preparing the consolidated financial statements of a multinational group whose consolidated revenue exceeds KRW1 trillion during the preceding fiscal year.
- In case the ultimate parent company is a foreign company or a non-resident of Korea, the filing obligator is a Korean affiliated company of a multinational group whose consolidated revenue exceeds 750 million Euros (or equivalent) in the preceding fiscal year if any of the following conditions are met: i) there is no obligation to submit a CbCR under the laws and regulations of the country where the ultimate parent company is established; or ii) there is no arrangement for the exchange of CbCR information between Korea and the country where the ultimate parent company is established.

The filing obligator may be exempted from the CbCR requirement in the following cases, provided that the information relating to the filing obligator is submitted:

- Where another domestic affiliate which belongs to the same multinational group submits a CbCR;
- If the ultimate parent company requests an affiliate located in a third country to submit a CbCR on behalf of the company and the CbCR is exchanged between Korea and the country where the affiliate is located.

Covered Scope of Entities

A filing obligator is required to prepare and submit a CbCR for affiliate companies which belong to a multinational group.

MOSF Publish Rewritten Corporate and Individual Income Tax Laws in Draft Form

The government has undertaken initiatives to rewrite tax laws since 2011. As part of these initiatives, the MOSF has announced the entire amendments to the Corporate Income Tax Law (CITL) and the Individual Income Tax Law (IITL) in draft form, which will be submitted to the National Assembly for approval with modification, if any, at the end of March. These initiatives are aimed to restructure tax laws in a more systematic format from the perspective of taxpayers so as to help taxpayers easily find and understand the tax laws and related provisions that are complicated and difficult.

Key points of the rewritten CITL include:

- The format of the tax laws is restructured from the current four steps (chapter, section, subsection and article) to five steps (part, chapter, section, subsection and article), and the number of articles increases from 142 to 190.
- The tax laws are divided by taxpayer between the domestic corporation part and the foreign corporation part. The domestic corporation part is subdivided into the taxable income chapter and the taxation method chapter.
- A new chapter is created to separately cover certain types of income and procedures which are currently included in the taxable income chapter, such as income from the sale of land, etc., excess corporate earnings reserve, and income tax withholding.
- The complex sentence structure is reformed to enhance the legibility of taxpayers by using more tables and formulas.

Key points of the rewritten ITTL include:

- The format of the tax laws is restructured from the current four steps (chapter, section, subsection and article) to five steps (part, chapter, section, subsection and article), and the number of articles increases from 223 to 306.
- Tax liabilities are separately stated on an income by income basis so that taxpayers may easily grasp the tax liabilities related to their income, and the obligation to pay tax on retirement income of residents is regulated in a separate chapter.
- New regulations have been introduced to outline the tax base, calculation procedures and taxation method by income in a way to make it easy for taxpayers to find necessary information.
- The complex sentence structure is reformed to enhance the legibility of taxpayers by using more tables and formulas.

WTO Agreement of Trade Facilitation Enters into Force

Effective February 22, 2017, the Agreement on Trade Facilitation (TFA) came into force as 112 out of a total of 164 members of the World Trade Organization (WTO) accepted the agreement. The TFA is designed to help improve the transparency of customs regulations, reduce red tape of customs compliance, information exchange among customs authorities, and preferential treatment for developing countries. It also aims to facilitate customs clearance, reduce related costs and ultimately expand cross-border trade. The TFA is the first multi-lateral trade agreement executed since the establishment of the WTO. In particular, it is considered a landmark agreement in the history of the WTO in that it obligates developing countries and least developed countries to fulfil their obligations in accordance with their ability to implement, and introduces the rules mandating the support of developed countries for these countries.

With the TFA taken effect, the WTO expects that the agreement would contribute to a 14.3% decline on average in the world trade and customs compliance costs, an increase of US$1 trillion in world exports and a 0.54% GDP growth worldwide. As customs clearance procedures, in particular, of developing countries are expected to improve, the agreement would relieve Korea's small and midsize exporters of certain regulatory burdens and practices that have impeded their exports to developing countries, such as redundant procedures and excessive costs for customs clearance, complicated customs regulations by region, unreasonable classification of export items and collection of customs duties and delay in inspection and customs clearance of fresh food products, according to the Ministry of Industry, Trade and Energy.

Rulings Update

Whether it is permissible to reinstate a tax assessment withdrawn by the tax authority

For the assessment of property tax (including surtax) by the Korean tax authority, a taxpayer filed an appeal with the tax authority against the tax assessment and the tax authority concluded that the taxpayer has justifiable reasons for the tax appeal by voluntarily cancelling its tax assessment. However, the tax authority later made the same tax assessment on the taxpayer. Regarding this, the Supreme Court ruled that it is against the law to revoke the previous withdrawal of the tax assessment and to reinstate the same tax assessment without having underlying facts or evidence to revoke the withdrawal, *for instance*, those showing that the previous withdrawal by the tax authority was based on illegitimate means such as fraudulent or incorrect documents submitted by the taxpayer. (*Daebeop 2016du56790, 2017. 3. 9*)

Whether payment of excess common costs is subject to output VAT

Two companies entered into an agreement for common cost allocation where they agreed to share costs commonly attributable to certain business operations as prescribed in the agreement. The companies respectively paid personnel costs and overhead costs incurred for the office management and maintenance, etc. which were allocated according to the agreement.

The tax offices having jurisdiction over these companies challenged the method for common cost allocation taken by the companies. The tax offices therefore recalculated the ratios for the allocation of common costs pursuant to the tax laws and disallowed the deduction of the input VAT relating to the amount of common costs borne by the companies in excess of the allocable costs as per the recalculated ratio. Additionally, the tax offices assessed output VAT to those companies as if additional services were separately provided by one party to the other party to the extent of the excess common costs borne by them. These companies disagreed with the VAT assessment and filed an appeal with the courts.

The Supreme Court decided that it is against the law to assess output VAT as if VAT-able services were separately provided by one party to the other party for the excess costs. The Court decision was based on various grounds including that: i) it would be difficult to identify a legal and contractual basis for the provision of separate services by one party to the other party to the extent of the excess costs even though the input VAT on the excess costs was disallowed under the tax law; and ii) if it is viewed that the services were separately provided and output VAT should be charged thereon, the input VAT previously disallowed would become deductible as an expense directly related to the provision of VAT-able services, thereby leading to incompatible results for the input VAT treatment. (*Daebeop 2016du55605, 2017. 3. 9*)

Whether to include tax reserve not used for not for profit purposes in taxable income

According to Article 29, Paragraph 1 of the CITL effective prior to the amendment on December 30, 2010, a nonprofit company can set aside a tax reserve (as a deduction from taxable income) for future expenditure to be used for its not-for-profit purposes as permitted by the law. The tax reserve amount should be used for the not-for-profit purpose within 5 years from the end of a fiscal year in which the reserve is deducted and any unused reserve should be included in taxable income in the fifth fiscal year after the deduction is taken (i.e., five year grace period).

However, where the tax reserve for nonprofit purpose is used for business purposes other than not-for-profit purposes, and it is obvious that the tax reserve cannot be used for nonprofit purposes any longer, thereby losing the ground for granting tax deferral on the reserve for the five year grace period, the tax reserve equivalent to the amount used for other business purposes should be added back to the taxable income for the fiscal year when the underlying reason occurs, regardless of the five-year grace period, according to a recent decision published by the Supreme Court. (*Daebeop 2016du59249, 2017. 3. 9*)

Application of special treatment for business purpose car related expenses

In response to a taxpayer's inquiry on the deduction rule for business purpose car related expenses, the MOSF set out the following:

- Article 27-2 of the CITL (i.e. special tax treatment for business purpose car related expenses) shall not be applicable to cars maintained and used in overseas business places of a domestic company.

- Only for the first fiscal year beginning on or after January 1, 2016, in case a company's car was insured for a limited period of time out of the entire fiscal year (or out of a rental period during the fiscal year in case of a rental car), the expenses used for business purposes pursuant to Paragraph 2 of Article 27-2 of the CITL shall be calculated using the following formula:

Business purpose car related expenses × the percentage of business use × (the number of days actually insured by the business use car insurance coverage for a fiscal year on or after April 1, 2016 to the end of a fiscal year ÷ the number of days required to enroll business use car insurance for the fiscal year on after April 1, 2016 to the end of the fiscal year)

- Article 27-2 of the CITL should apply to cars rented by a domestic company engaged in car repairing and maintenance business to its customers for car repairing services for a repairing period (*Ministry of Strategy and Finance, Corporation Tax Bureau-320, 2017.3.6.)*

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