

# Korean Tax Brief

## Update on Current Issues and Trends



### 1. Tax News

#### (1) Tax Tribunal : improvement on the tax appeal process

On September 26, the Tax Tribunal announced measures to strengthen the effectiveness of protection of taxpayer's rights. The Tax Tribunal had been criticized for not being able to hold expedited and faithful hearings whereupon the average processing period in 2017 was 157 days (greatly exceeding the statutory 90 days) and the number of hearings rose to approximately 7,000 cases a year. The new measures will introduce detailed application processes to be implemented based on the following key principles.

- Implementation of standard processing procedures : Hearings for small claims cases and cases involving straightforward backgrounds will be expedited within 90 days. Hearings involving cases that require thorough review will be concluded within 180 days and will provide sufficient opportunity for defense.
- Prompt case assignment: A judge will be assigned to proceed the hearing within 20 days upon receipt of the case regardless of whether a written response is submitted by the tax authorities.
- Provide sufficient opportunity for claims: At least 3 sessions of claims and refutation (2 weeks of defense opportunity per session) will be provided to both the claimant and the tax authorities in the process of case investigation to ensure integrity of procedural rights and to strengthen the fairness of defense and response procedures.

It is anticipated that the procedural supplement will allow the filed cases to be thoroughly examined and its conclusion period to be reasonably predicted.

#### (2) Ministry of Economy and Finance announces measures to promote financial decentralization

In order to enhance the autonomy and accountability of the provinces and to promote balanced development within the nation, on October 30, the government finalized and announced the 「Plan for Financial Decentralization」 through consultation with the relevant authorities and local governments. The plan is based on the fundamental of transferring significant functions and finances of the central government to provinces and includes measures to reform the portion of taxes received by each government bodies to 7:3 (national tax : local tax) by 2022, etc. Moreover, the promotion plan will increase the portion of taxes being transferred to provinces incrementally from the current 11% to 15% in 2019 and 21% in 2020.

Although under current measures the plan is to transfer national tax to local tax without increasing the tax burden on the citizens and taxpayers, it would be important to continuously monitor further developments as new rules and regulations may be introduced.





### **(3) Ministry of Economy and Finance convenes state council meeting for amendment of temporary decrease in fuel tariff**

The government convened the 46th State Council Meeting on Tuesday, October 30, and passed temporary measures to decrease fuel tariff in the Enforcement Decree of Transportation · Energy · Environment Act and the Enforcement Decree of Individual Consumption Tax Act. This amendment provides temporary decrease in fuel tariff on gasoline, diesel, LPG by 15% from November 6, 2018 to May 6, 2019 to relieve the burden on self-employed small business owners, small and medium-sized businesses, and working classes who are struggling through the recent rising gas prices, stagnant domestic economy, etc. This amendment is expected to result in price decreases (including 10% of VAT) in gasoline by 123 won/ℓ, diesel by 87 won/ℓ, and LPG by 30 won/ℓ.

## **2. Recent Regulations and Precedents**

### **(1) Obligation of VAT payment by proxy (Ministry of Economy and Finance Value-Added Tax Bureau-589, 2018.09.18)**

In case where a non-profit sports committee receive services relating to public relation consulting, other supporting services, etc., from a foreign corporation without a domestic place of business, the committee is liable for the 10% VAT payment by proxy to the extent that the committee uses or consumes above services or rights in Korea.

### **(2) In come classification of conditional payments in connection with share transfer (Ministry of Economy and Finance 2018.10.08)**

Where a domestic corporation acquires shares in a Danish Company that is not listed on the securities market nor has a domestic place of business in Korea, and enters into an agreement to make (i) initial payment for transferring the name of inscribed securities and (ii) additional payments to the alienator when certain conditions satisfied, such conditional payment shall be deemed as capital gains from transfer of shares and not be taxable in Korea in accordance with the Article 13 of Korea-Denmark Tax Treaty.

This precedent was issued to reverse a prior interpretation issued in 2016 by the NTS stating that capital gains could be deemed royalty fees for tax purpose in certain circumstances under the principle of substantial taxation.

### **(3) Obligation to pay acquisition tax when becoming a controlling shareholder without securing substantial governing power (GamSim 2017-9, 2018.10.08)**

The current tax law stipulates imposition of (deemed) acquisition tax on the controlling shareholder of a company considering that the controlling shareholder is expected to be in a position to dispose of or manage assets held by the company thereby can be deemed to effectively hold such assets subject to acquisition tax. In regards to this, the tax law does not require the controlling shareholder to actually exercise of right on shares.

Therefore, the controlling shareholder has an obligation to pay deemed acquisition taxes even if the controlling shareholder does not have substantial control due to certain exceptional circumstances related to the transaction. Therefore, the imposition of deemed acquisition taxes on the controlling shareholder by the tax authorities is appropriate.

**(4) It is appropriate to assess corporate income tax (subject to withholding) to the appellant by treating Company A, a beneficial owner of the royalty income, rather than Company B, a nominal income recipient (Josim 2017Seo1060, 2018.09.19)**

The appellant entered into a film distributorship agreement with Company A in 2006, and paid related royalty income (hereinafter, 'royalty income') to Company A after withholding taxes at a rate of 15% as prescribed in the Korea-Netherlands Tax Treaty. In May 2011, the appellant entered into a new film distributorship agreement with Company B, a wholly-owned Hungarian subsidiary of Company A and has since paid royalty fees to Company B. Based on the Korea-Hungary Tax Treaty, no taxes were withheld from royalty fees paid to Company B.

The appellant was unable to submit any contracts for the transfer of distribution rights from Company A to Company B nor any related payment details, and the right is not accounted on the financial statements of Company B.

Considering such matters, Company B shall not be seen as a company that is eligible for receiving royalty fees for the intellectual property rights for films, but rather an intermediary pass-through company which merely transfers the royalty income to Company A.

In this regard, assessing corporate income tax by treating Company A as the beneficial owner in substance rather than Company B shall be considered appropriate.

**(5) It is appropriate to apply 15% of reduced tax rate according to the Article 10(2)(b) of Korea-Sweden Tax Treaty by considering the beneficial owner of the issue dividend as a Swedish Company C (Josim 2017Seo2886, 2018.10.16)**

Swedish Company A, a Norwegian Company, and a Korean Company each owned 40%, 40%, and 20%, respectively, of the appellant's share at the time of its establishment. Subsequently, Swedish Company A transferred its shares of the appellant to a related Swedish Company B, a newly incorporated holding company within the same group as Company A. The appellant applied 10% of reduced tax rate to the dividend income paid to Swedish Company B (hereinafter, "dividend income") prescribed by the Article 10(2)(b) of Korea-Sweden Tax Treaty.

Swedish company B does not have human resources nor physical presence, thus, in substance, appears to be a formally existing conduit company. In addition, the dividends appear to have been substantially attributed to the Swedish corporation C, which is the parent company of Swedish company B. In this case, even if there is no treaty shopping for tax avoidance, it would be appropriate to view that the Swedish corporation C owns the shares in the Korean company but in an indirect manner. As a result, the withholding tax should be calculated by applying 15% of the Korea-Sweden tax treaty rather than 10% which is applicable for the direct ownership.



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