Executive summary

On 31 December 2019, Korea enacted the 2020 tax reform bill (the 2020 Tax Reform) after it was passed by Korea's National Assembly on 10 December 2019. Unless otherwise specified, the 2020 Tax Reform will generally become effective for fiscal years beginning on or after 1 January 2020. The Enforcement Decrees, which provide more specific guidance on the laws, are expected to be enacted in February 2020.

This Alert summarizes the key features of the new and amended tax laws.

Detailed discussion

Taxation of royalties for patents registered outside of Korea

The 2020 Tax Reform provides that any payments for manufacturing know-how, technologies, or information contained in patents rights registered outside of Korea that are used in domestic manufacturing or production activities in Korea will be deemed to be Korean source royalty income by recasting such payments as royalties for the use of “other similar properties or rights” under the Korean Corporate Income Tax Law. The rule applies to payments made on or after 1 January 2020.
In addition, the 2020 Tax Reform introduces a new rule that if a Korean entity pays compensation to any patent holder for the infringement of a patent registered outside of Korea, the payment is classified as “other income” subject to the 16.5% Korean statutory withholding tax rate, including the 10% surtax. The rule applies to payments made on or after 1 January 2020.

Korean source gain on disposition of real property company securities
To secure the taxing right of Korean-sourced income on the disposal of real property company securities, the 2020 Tax Reform includes Korean-sourced real property company security gains in the scope of a mutual agreement with certain countries that have a tax treaty with Korea. Accordingly, gains on the disposition of Korean real property holding company shares are Korean source, subject to Korean tax.

This treatment applies to nonresident individuals and corporations.

New requirements for “abusive transactions”
The Korean Law for the Coordination of International Tax Affairs (LCITA) includes a “substance over form” principle regarding taxpayers who undertake an abusive transaction with the intent to obtain a tax benefit under a tax treaty.

Under the 2020 Tax Reform, when a transaction reduces the tax liability by an amount specified in the Presidential Decree of the LCITA (e.g., 50%), the burden of proof is placed on the taxpayer to prove that the transaction has a valid business purpose, without the intent of tax avoidance. Failure to meet the requirement results in the transaction being treated as an abusive transaction and subject to tax in accordance with the “substance over form” principle under the LCITA.

Installment tax payments on capital gain on in-kind contributions
Under the 2020 Tax Reform, when a qualified in-kind contribution is made to form a new Korean holding company or convert an existing Korean company to a Korean holding company, any capital gains tax on the contribution will be paid in installments over three years, beginning in the fifth year of the in-kind contribution. This rule applies to in-kind contributions/share transfers occurring on or after 1 January 2022.

Reduction of securities transaction tax
The 2020 Tax Reform reduces the 0.5% securities transaction tax rate to 0.45% for over-the-counter and unlisted security transactions. The reduced rate applies to transactions occurring on or after 1 April 2020.

Document submission requirement for international transactions
The 2020 Tax Reform provides an exemption from the requirement to submit the Korean statement of international transactions for taxpayers who are required to file master/local files.

In addition, if taxpayers fail to file documents that substantiate the arm's-length pricing method by the statutory due date without reasonable cause, the Korean tax authority may apply an arm's-length price based on information from taxpayers undertaking a comparable business.

Additional transfer pricing (TP) documentation failure-to-file penalty
The current law imposes a penalty of up to KRW100 million (US$85,000) if a taxpayer fails to file TP documentation within the statutory time frame or files false documents. From 1 January 2020, an additional penalty of up to KRW200 million (US$170,000) may be imposed every 30 days after the first penalty assessment until the requested TP documents are filed.

Increased maximum penalties for withholding tax
Currently, a taxpayer who has not paid the full tax amount withheld or has not withheld tax by the statutory due date may be subject to penalties of up to 10% of the unpaid or under paid withholding tax amount. The 2020 Tax Reform increases the maximum penalty to 50% of the unpaid or under paid withholding tax amount.
Endnotes


2. The term “real property” includes shares of a Korean corporation if the value of real property held by the corporation equals or exceeds 50% of the value of total assets of the corporation (real property holding company).


4. This is an amendment to the Enforcement Decree which is expected to be enacted in February 2020.

5. A taxpayer is required to submit the documents within 60 days from the date of request. A one-time extension of up to 60 days may be available.

6. This is an amendment to the Enforcement Decree which is expected to be enacted in February 2020.

7. This is an amendment to the Enforcement Decree which is expected to be enacted in February 2020.

8. The revised maximum penalty will be capped at 10% in the period between the statutory due date and the tax payment notice date.

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