삼정 KPMG

October 2019, Issue 110

Korean Tax Brief

Update on Current Issues and Trends

1. Tax News

(1) Update on the OECD's work on addressing the tax challenges of the digital economy

On October 30, 2019, the Ministry of Economy and Finance (MoEF) held press briefing session on taxing the digital economy being developed by the OECD.

It is likely that taxation on digital economy, so called 'Google Tax', will also affect local conglomerates including Samsung Electronics and Hyundai Motor.

The OECD's work on addressing the tax challenges of the digital economy currently consists of two pillars. Pillar One deals with the allocation of taxing rights to market and user jurisdictions, and Pillar Two focuses on global minimum taxation. The OECD anticipates that these proposals will lead to a significant increase in global tax revenues. The OECD Secretariat's recent proposal in early October relates to devising a "unified approach" for Pillar One, and consultation document on Pillar Two is expected to be released in November 2019.

The unified approach under discussion for Pillar One broadly includes all multinational consumer facing businesses, including IT enterprises, even if they are not highly digitalized. Thus even manufacturers of mobile phone, electronic appliances, vehicles, etc., can be subject to the new taxation approach when their revenue exceeds certain threshold. However, OECD is considering carving out certain sectors that are not consumer-facing or have low risk of tax evasion (e.g., extractive industries, commodities, financial services) in the scope.

MoEF official from international tax department explained that it is highly likely for Samsung Electronics, LG Electronics and Hyundai Motor to be within the scope as large consumer facing businesses, though specific details have to be in place to review how they will be taxed.

The new digital economy taxation primarily focuses on strengthening taxing right of market jurisdictions involved. It includes allocation of taxing rights to jurisdictions regardless of existence of local entities based on nexus rule when sales in the specific jurisdiction exceeds certain threshold.

The amount of tax will be determined based on the multinational business's residual profit and activities carried out in each jurisdiction (marketing, distribution and other functions exceeding the baseline activity). To do so, there has to be a global consensus solution regarding the level of deemed routine profit for multinational enterprises, profit allocation, new nexus rule and threshold on taxation.

Under the proposal, share of deemed residual profit (a multinational enterprise's profit less deemed routine profit) will be allocated to market jurisdictions irrespective of the location and residence of that business.

For example, if multinational enterprise A's profit margin is 20%, with 10% deemed routine profit margin, and each market jurisdiction has allocation rate of 20%, and nexus threshold is 1,000, tax base will be the 10% of global profit exceeding routine profit (10%):

	Country 1	Country 2	Country 3	Country 4	Country 5
Revenue	4,000	6,000	500(**)	1,000	3,000
Tax base per country(*)	80	120	NA	20	60

*. Revenue x (global profit 20% - routine profit 10%) x allocation ratio (20%)

**. Below nexus threshold

***. The allocation rate and nexus threshold used in the above example are only illustrative examples, and there are no specific rates or threshold amounts provided by the OECD.

In addition to the above, fixed rate of taxation can be applied for a subsidiary in market jurisdiction providing marketing and distribution, while additional taxing right can exist on other activities such as providing remote streaming services to another jurisdiction.

For discussions on Pillar Two introducing a minimum tax rate on all profits of internationally operating businesses, the parent entity's taxable income can be adjusted when the applied tax rates in subsidiaries' jurisdictions are lower than the global minimum tax rate. Details for this minimum tax are also still under discussion.

The Korean government views that taxation on digital economy will not only affect Korean companies but also the overall tax revenue. The government has formed its Task Force team in March 2019 to analyze the impact of implementation of digital era taxation and review their implementation.

OECD is holding public consultation meeting for the proposed "unified approach" under Pillar One during 21 and 22 November 2019 in Paris. A separate public consultation meeting on Pillar Two minimum tax rate issues will be held on 13 December 2019. The final report will be issued in 2020 by Inclusive Framework during 29 and 20 January, 2020 and a consensus solution will be devised by the end of 2020. Thereafter, agreements between jurisdictions and legislation processes would follow.

(2) NTS is considering an introduction of mandatory disclosure rules on potential aggressive tax avoidance transaction

The National Tax Service (hereinafter "NTS") had requested external tax advisors to review approaches in implementing mandatory disclosure rules on tax avoidance transaction, and the study was recently completed.

According to the report prepared by the advisors, the study generally supports the implementation of disclosure rules, considering increasing number of multinational companies and investments engaging in tax avoidance by artificially shifting profits to low-tax countries or exploiting gaps and mismatches in tax rules between two countries.

Such regime would mandate taxpayers, legal advisors or tax attorneys to report aggressive tax avoidance arrangements to the tax authority in advance.

OECD also recommends implementation of mandatory disclosure rules (BEPS Action 12) to improve transparency and certainty by providing the tax administration with early information regarding potentially aggressive or abusive tax planning. Six countries including the U.S., U.K. and Canada have already adopted this system.

From its implementation, the NTS expects to effectively react to new types of tax avoidance transactions, reduce information asymmetry by receiving supporting information (i.e. details of contracts and revenue model) from taxpayers substantiating their defense to the claim from NTS, and enhance the efficiency of tax administration by reducing administrative processes related to tax audits for past fiscal years and tax appeals.

(3) The number of tax audits targeting corporations with annual sales of over KRW 100 billion increases

Based on the information provided by the NTS to the National Assembly, the number of tax audits targeting corporations with annual sales of over KRW 100 billion was 804 last year which was increased by 35 percent compared to the last year.

The number of tax audits for corporations with annual sales of over KRW 100 billion has increased from 642 in 2015 to 804 in 2018, which contrasts with the decrease in the total number of tax audits for all corporate taxpayers (5,577 in 2015 to 4,795 in 2018).

The amount of tax collection from tax audits for all corporations has decreased from KRW 5.51 trillion in 2015 to KRW 4.56 trillion in 2018, but the proportion of tax collection from corporations exceeding KRW 100 billion annual sales over the amount of total tax collection from all corporations has increased from 48 percent (KRW 2.17 trillion over KRW 4.50 trillion) in 2017 to 68 percent (KRW 3.92 trillion over KRW 4.56 trillion) in 2018.

(4) Tax revenue for the first eight months of the year is KRW 3.7 trillion less compared to last year

The Ministry of Economy and Finance announced that the government collected KRW 209.5 trillion in taxes in the first eight months of the year, which is KRW 3.7 trillion less than that of the same period in 2018.

In August alone, tax revenue reached KRW 20.2 trillion which was below KRW 2.8 trillion from August 2018. Among this amount, Corporate Income Tax (CIT) revenue was KRW 11.9 trillion (down KRW 0.6 trillion from August 2018 due to decrease in interim CIT amount resulting from decline in companies' profit level).

Meanwhile, Customs revenue was KRW 0.7 trillion, down KRW 0.1 trillion from the same period last year, due to the decrease in import.

(5) Tax collection from those committing offshore tax evasion was over KRW 1,300 billion last year

According to information submitted by NTS to the National Assembly, the NTS audited 226 cases of potential offshore tax evasion and collected additional taxes amounting to KRW 1,338 billion last year.

While the number of tax audits on offshore tax evasion has remained at a similar level of around 200 cases every year since 2014, the amount of tax collection has gradually increased every year, KRW 1,307 billion in 2016 and KRW 1,319 billion in 2017.

NTS announced in May that it had launched nationwide tax audits on 104 individuals and corporations (83 residents and domestic corporations, 21 foreign multinational corporations) for alleged offshore tax evasion and plans to intensively investigate aggressive tax avoidance schemes such as intangible asset transaction, restructuring of multinational companies and avoidance of permanent establishment status.

2. Recent rulings

(1) VAT shall be exempted for a facility donated to the local government in return for obtaining business related approval from the local government (Sajeon-2019-Interpretation of Value Added Tax Law-0362, 2019.08.28)

The Value Added Tax (hereinafter "VAT") Law stipulates that VAT is exempted on goods provided for free or donated to national and local governments.

In relation to this stipulation, the NTS interpreted that providing a facility to the local government in order to obtain necessary business approval from the local government shall still be deemed as VAT-exempted donation, since administrative action of the local government can't be considered as goods or services with monetary value, which may be viewed as monetary consideration given in return for donated facility.

In addition, NTS interpreted that if approved business is VAT-taxable business, input VAT incurred by the company related to the construction of the facility (excluding land-related input VAT) would be deductible from its output VAT.

(2) If a company purchased land with known restriction for business use, capital gain from sale of the land is subject to additional CIT (Tax Tribunal 2019Seo0391, 2019.07.30)

Under the CIT Law, 10% of capital gain from sale of non-business use land should be additionally included in taxable income of the company. As an exception, land that was not able to be used for business purpose as 'land with restriction on its use based on relevant law' is not subject to this rule.

Company B, a fishery product distribution business, acquired land to build its logistics center with acknowledgement of existing city planning to continuously use part of the land as road. The company failed to obtain an approval for repurposing of road site for logistics center construction and ended up selling the land after few years. NTS insisted that the transfer of land should be subject to additional CIT as it was never used for business purpose after acquisition.

While the taxpayer argued that its circumstances qualify for the 'land with restriction on its use based on relevant law' under the CIT Law whereby additional CIT on capital gain for non-business use land is not applicable, provided that it initially intended to use the land for business purpose but was not able to do so due to issues in obtaining approval from the city government to change use of land.

The Tax Tribunal interpreted that the exception clause under the CIT Law only refers to cases where the use of land is restricted or prohibited only after their acquisition.
The interpretation also provides that whether the company purchased the land for investment purpose or not would not affect this tax treatment, and as the company was already aware of the restriction in having to use part of the land as road at the time of acquisition, NTS's tax treatment is justifiable.

(3) Even when the timing of service fee settlement is uncertain, the time of supply of service for VAT purpose is still when the provision of the service is completed (Supreme Court 2017du47564, 2019.09.09)

Company A provided brokerage service in concluding the contract for the sale of yachts between Company C and Company D on August 24, 2009. Company C delivered the yacht to D on October 15, 2009, but Company D delayed the payment; due to continuous disputes between Company C and D, a Law firm was newly engaged to mediate the dispute and the plaintiff transferred the brokerage fee receivable to the Law firm. Subsequently, the settlement and payment of the yacht transfer were executed on December 5, 2012. Consequently, Company C paid the brokerage fee to the Law firm, and the Law firm issued a tax invoice to Company C.

Defendant (NTS) viewed that the company which provided brokerage services to C was Company A, and not the Law firm, and that the time of supply of brokerage service was 2009 rather than 2012. Accordingly, it initially provided a notification correcting the amount for VAT and CIT of 2009.

According to the judgment of Supreme Court, supply of services shall generally be constituted when the service is provided, and whether or not the payment is actually made will not affect the timing of VAT reporting. In addition, for CIT purpose, right for receivable shall be deemed to have been determined when the receivable is recognized unless there are legal restrictions on exercise of that right. Thus while companies may later deduct any receivable that is certainly not recoverable, it would not change the fact that the amount must be included in the taxable income when the right is established. Therefore, the Supreme Court ruled that NTS's treatment was appropriate.

(4) Calculation method of the limit on Tax Reduction for Foreign Investment for merged foreign-invested companies (Written-2019-Interpretation of Adjustment of International Taxes Act-0887, 2019.08.16)

When 2 foreign-invested companies that have each applied for Tax Reduction for Foreign Investment become a single entity after a qualified merger under the CIT Law, and if the financial information of each company's legacy business is separately maintained, the tax reduction amount would be calculated for each business separately and each company's legacy foreign investment amount before the merger should be the limit on the tax reduction for each business.

(5) When the supply value of the car rental fee includes insurance premium, the entire rental fee is still subject to VAT (Ministry of Economy and Finance, Division of VAT-493, 2019.08.13)

Under the VAT Law, VAT is exempted for financial and insurance services while car rental services are subject to VAT (excluding lease transactions of registered lease business).

When a rental car company subscribes for a car insurance policy chosen by its customer for car rental and includes the equivalent amount of the insurance premium in the rent received from the customer, the amount pertaining to insurance premium should still be subject to VAT as a payment for car rental services, and shall not be considered as fee for financial and insurance services.

(6) Responses from NTS's Internet consultation service can't be considered as formal opinion from the tax authorities (Tax Tribunal 2019Seo1991, 2019.07.29)

An individual housing sales business owner made an inquiry on the Internet consultation board of the NTS regarding whether he can apply simplified expense ratio method on his business income with explanation of facts about his business. According to the response provided by the NTS consultant, the individual viewed that he would be eligible to apply the simplified expense ratio method when filing his annual comprehensive income tax return.

However, the Tax Tribunal concluded that ignorance or misunderstanding of the law is not a justifiable reason for violation of taxpayer's obligation, and that the simple response from the NTS Internet consultant is not formal opinion expressed by the tax authorities. Therefore, it ruled that the taxpayer can't be exempted on relevant penalties even if he filed his tax return based on NTS's Internet consultation.

KPMG contacts

For more information about how KPMG Tax can help your business with tax matters, please contact one of the following professionals.

Head of Tax

Yoon, Hak Sup
T. 82(2)2112-0436
E. haksupyoon@kr.kpmg.com

Head of Global Tax

Oh, Sang Bum
T. 82(2)2112-0721
E. sangbumoh@kr.kpmg.com

Partner of Global Tax

Lee, Sung Wook
T. 82(2)2112-0946
E. sungwooklee@kr.kpmg.com

Kim, Dong Hoon
T. 82(2)2112-0938
E. dkim@kr.kpmg.com

Cho, Sang Hyun
T. 82(2)2112-7687
E. sanghyuncho@kr.kpmg.com

Suh, Yu Jin
T. 82(2)2112-0930
E. yujinsuh@kr.kpmg.com

Partner of Global Tax(Japanese Practice)

Kim, Jung Eun
T. 82(2)2112-0283
E. jungeunkim@kr.kpmg.com

Oh, Ik Hwan
T. 82(2)2112-0275
E. ikhwanoh@kr.kpmg.com

kpmg.com/kr