



Providing Excellence In Client Services

January 2016

Newsletter

Bi-monthly Newsletter of Hanul Choongjung LLC

Contents

■ Tax Law Changes in 2016

1. Corporate Income Tax Law (CITL)

2. International Tax Coordination Law (ITCL)

3. Individual Income Tax Law (IITL)

4. Value-Added Tax Law (VATL)

5. Other Items of Interest

This newsletter is prepared and issued by Hanul Choongjung LLC on a bi-monthly basis and intended to provide foreign investors with an update on tax law changes in Korea and other related subjects of special interests to foreign investors. The information provided herein should not form a basis of any decision as to a particular course of action, nor should it be relied upon as a substitute for a detailed advice in individual cases.

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(You may find this newsletter and other items of interest at <http://www.crowehorwath.net/kr/>)

■ Tax Law Changes in 2016**Tax Law Changes in 2016**

Proposed tax law changes announced by the government in August 2015 were approved by the National Assembly in December 2015 with several amendments and additions. We summarized below some of the major tax law changes for 2016 to keep you updated. Most of the tax law changes we discussed below came into force from the fiscal year starting, or income earned, on or after January 1, 2016, unless indicated otherwise.

1. Corporate Income Tax Law (CITL)**■ Annual deduction limit of tax loss carry-forward (CITL, Article 13)**

Under the previous corporate income tax law, tax loss was allowed to be carried forward for 10 years and fully deducted from taxable income. However, under the amended CITL, a company which is not classified as a Small and Medium sized Enterprise (“SME”) may utilize its tax loss carry-forward only within certain limit. A deduction limit of the tax loss carry-forward for non-SME (excluding non-SME under a business rationalization plan, workout plan, etc.) is 80% of the taxable income of the fiscal year.

■ Limitation on deductible company vehicle-related expenses (CITL, Article 27-2)

The purpose of this amendment in CITL is to prevent taxpayers from using business purpose vehicles for personal use or abusing the tax deductions allowed for company vehicle with expensive vehicles.

For the company vehicle related expenses to be treated as tax deductible for corporate income tax purposes, the following conditions should be satisfied:

- a. The company should purchase car insurance that allows only directors/employees of the company to drive the vehicles and be covered under the insurance. Without such insurance, any company vehicle related expenses will be disallowed deduction; and
- b. The company should maintain a detailed driving log for the reporting to the National Tax Service (NTS).

This driving log requirement is waived if the company vehicle related expenses are KRW 10 million per car and per year or less for each company vehicle. However, if the company vehicle related expenses are over KRW 10 million per car and per

year, the company must prove that the car has been used for business purposes by providing a detailed driving log (vehicle type, total annual mileage use by vehicle type, mileage use for business purpose, car related expenses including depreciation, lease, fuel, vehicle tax, car insurance, etc). Actual usage ratio of the expenses shall be allowed if such actual usage ratio for business purposes is proved through a daily driving log.

Under the amended CITL, annual depreciation and loss on disposal of assets incurred in relation to a vehicle will be allowed deduction for up to KRW 8 million per year. Also, the depreciation equivalent included in the lease or rental fee will be subject to this annual depreciation deduction limit of KRW 8 million per car. The amount in excess of the limit will have to be carried forward for deduction in the following years.

Under the current CITL, a company can choose the period of depreciation between 4-6 years. However, vehicles purchased in 2016 and after will be subject to the depreciation of five years.

■ **Compulsory requirement of electronic tax invoice issuance and submission to the National Tax Service for all VAT-exempted corporate taxpayers (CITL, Article 76)**

VAT-exempted taxpayers have been allowed to issue either electronic tax invoices or paper tax invoices as issuing electronic tax invoice was not mandatory before the revision, which raised transparency concerns.

From July 1, 2015, VAT-exempted taxpayers shall be required to issue electronic tax invoices for all transactions and submit them to the National Tax Service the same as regular taxpayers. For non-compliance, additional penalty taxes will be imposed from January 1, 2016.

2. International Tax Coordination Law (ITCL)

■ **New reporting requirement for transfer pricing documentation (ITCL, Article 11)**

In July 2013, the Organization for Economic Cooperation and Development (“OECD”) and G20 countries adopted the Base Erosion and Profit Shifting (“BEPS”) prevention project, which aims to provide governments with clearer international solutions to fight against corporate tax planning strategies of multinational companies that exploit gaps and loopholes of the current system to

artificially shift profits to locations where they can be subject to more favorable tax treatment.

In line with the OECD's BEPS prevention project and Guidance on Transfer Pricing Documentation, the tax law change imposes a new documentation requirement for certain multinational companies to submit information on international transactions.

In order to comply with the recommendations of OECD/G20 BEPS prevention project, the amended ITCL requires a Multinational Enterprise ("MNE") with a certain size of transactions and assets (to be regulated in the Presidential Decree of ITCL) to submit additional transfer pricing ("TP") documentation (i.e., a comprehensive report on cross-border transaction information) together with its annual corporate tax returns, which would address management information and current status of cross-border transactions of the MNE.

Description	Main contents
Report I (Master file)	<ul style="list-style-type: none"> ● Comprehensive legal ownership structure and location of subsidiaries or offices of the MNE ● Explanation on major business restructuring, share acquisition, sale of business, etc.
Report II (Local file)	<ul style="list-style-type: none"> ● Detailed explanation on business and business strategies of local subsidiaries ● Explanation on major related parties and circumstances leading to related party transactions ● List of related parties involved and indication of relationship by the type of related party transactions

Affected taxpayers are Korean multinational corporations and foreign corporations having a PE in Korea that meet all of the following conditions:

- a. Annual gross sales of an individual entity exceed KRW100 billion; and
- b. International related party transaction exceeds KRW 50 billion per year.

Failure to comply with the reporting requirement will result in a noncompliance penalty of KRW30 million.

3. Individual Income Tax Law (IITL)

■ Capital gains tax on transfer of SME shares by major shareholders

Capital gains tax on transfer of SME shares was previously taxed at 10%, irrespective of shareholding ratio. Under the amended IITL, capital gains tax rate on transfer of SME shares owned by major shareholders (defined) increases from 10% to 20% the same as the non-SME shares.

■ Expansion of scope of major shareholders

A scope of major shareholders subject to capital gains tax on transfer of shares is expanded as follows:

Description	Previous	Amended
KOSPI and unlisted companies	i) ownership ratio of 2% or more; or ii) total share value of KRW 5 billion or more	i) ownership ratio of 1% or more; or ii) total share value of KRW 2.5 billion or more
KOSDAQ companies	i) ownership ratio of 4% or more; or ii) total share value of KRW 4 billion or more	i) ownership ratio of 2% or more; or ii) total share value of KRW 2 billion or more

The amended IITL will be applied to a transfer of shares made on or after April 1, 2016. However, the amended IITL for an unlisted company will be applied to a transfer of shares made on or after January 1, 2017.

The following table summarizes the new applicable capital gains tax rates by type of shareholders and corporations:

Shares issued by	Type of corporations	Type of shareholders	listed or unlisted transaction / Holding period	Tax rate	Effective date of the amended IITL
Unlisted companies	SME	Minor shareholders	All	10%	
		Major shareholders	All	20%	January 1, 2016
	Non-SME	Minor shareholders	1 year or more	20%	
		Major shareholders	Less than 1 year	30%	
Listed companies	SME	Minor shareholders	listed transaction	Non-taxable	
			unlisted transaction	10%	
	Non-SME	Major shareholders	All	20%	January 1, 2016
			Minor shareholders	listed transaction	Non-taxable
		Major shareholders	1 year or more	20%	
			Less than 1 year	30%	

■ **New withholding obligation on domestic company having foreign secondee (IITL, Article 156-7)**

Currently, a foreign secondee working in Korea who receives earned income from a foreign corporation outside Korea is not subject to payroll withholding tax on such Korea sourced earned income, but can voluntarily join a taxpayers' association to pay monthly payroll withholding tax to enjoy a 10% tax credit. The amended IITL requires a domestic company using foreign secondees to withhold payroll income tax at 17% when the domestic company pays service fees to the foreign corporation which dispatched the foreign secondees.

The domestic company having foreign secondees will be subject to the withholding obligation when making payments to the foreign corporation if all of the following conditions are met:

- a. The total amount of the service fees paid to a foreign corporation (or multiple foreign corporation involved) in return for services by the foreign corporation via foreign secondees exceeds KRW 3 billion per year; and
- b. The sales revenue of the domestic company making such service fee payment exceed KRW 150 billion or the total assets exceed KRW 500 billion during the preceding fiscal year; and
- c. The domestic company engages in air transportation, construction business, or professional, scientific and technical service business

For the withholding tax withheld and paid by the domestic company, the foreign company dispatching foreign secondees will be allowed to claim a refund of any overpaid withholding tax via a year-end settlement. A copy of the contract executed between the domestic company and the foreign secondees and documents to support the wages and salaries paid by the foreign company to the secondees should be submitted. These year-end settlement and refund claim procedures may be undertaken by the domestic company on behalf of the foreign company

The amended IITL will apply to payment made to a foreign company from July 1, 2016.

■ **Shift of retirement income deduction from the current fixed percentage basis to the progressive percentage basis (IITL, Articles 48 and 55)**

Before the tax law revision, retirement income deduction was made on the fixed percentage basis where we can deduct 40% of retirement income uniformly when calculating retirement income tax base. Under the revised IITL, to reduce tax burden of low income workers and increase tax burden of high income workers, the retirement income deduction was changed to the progressive percentage basis with the rates ranging from 35% to 100% of the original income deduction.

This amended IITL comes into force for the retirement income earned on or after January 1, 2016.

4. Value-Added Tax Law (VATL)

■ Narrowed scope of electronic services subject to VAT registration (VATL, Article 53-2)

Under the current VATL, nonresidents providing electronic services (e.g., games, sounds, video files, software, etc) in Korea must register for VAT purposes using a simplified online VAT registration method and pay the 10% VAT on its supply of electronic services from July 1, 2015. Under the amended VATL, the new VAT regime on electronic services will not apply if the electronic services are rendered to a domestic entrepreneur who is registered for VAT purposes in Korea (i.e., business to business(B2B) transactions). The amended VATL on electronic services is effective from the taxable period covering July to December 2015.

■ Reciprocal application of zero-rate VAT for certain services (to be regulated in the Presidential Decree of VATL, Article 33)

The zero-rate VAT applicable to certain services rendered to a nonresident person such as professional services (i.e., legal, accounting, tax, advertising, market survey, management consulting services, etc.) and business support services (i.e., manpower supply, employment delivery, and other business supporting services) will apply only in the case where a country where a counterparty is a resident of applies the same zero-rate VAT or exemption on such services (on a reciprocal basis). The amended VATL will be finalized after a presidential approval and shall apply to the supply of such services on or after July 1, 2016.

5. Other Items of Interest

- Ministers or practitioners for religious services will be subject to tax on income earned for their services from religious organizations effective from January 1, 2018.
- The range of the share transfer to be treated as a transfer of the real estate is extended to include a foreign company which transfers shares issued by a Korean company that owns real estate shares of another company.

- The range of Korean nationals residing abroad liable to report overseas financial account is extended depending on the staying period in Korea.

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