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Newsletter

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Contents

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.

■ Tax Law Changes in 2017

Proposed tax law changes announced by the government in July 2016 were approved by the National Assembly in December 2016 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, 2017**, unless indicated otherwise.

I. International Tax Coordination Law (ITCL)

■ Requirement for Country-by-Country(CbC) Reporting

Under the tax law changes, the Korean tax authorities have adopted the requirement to submit CbC reporting in line with the recommendations by the Organization for Economic Cooperation and Development (OECD) following the implementation of the new transfer pricing rules requiring multinational companies in Korea to submit local files and master files on their cross-border transactions, which is effective for the fiscal year starting from January 1, 2016.

Under the new CbC reporting in Korean tax law, the domestic (Korean) ultimate parent company of multinational companies with annual sales revenue exceeding KRW 1 trillion per consolidated financial statements for the preceding year is required to submit the CbC reporting to the Korean tax authority in addition to the master file and local files. The CbC reporting requirement applies to the fiscal year starting from January 1, 2016. It also applies to the Korean subsidiary or Korean branch of foreign headquartered multinational companies in certain cases (e.g., in the case where the parent company of foreign(non-Korean) multinational company is located in a country that does not require the parent company to prepare CbC reporting or does not agree with the exchange of CbC reporting).

The new CbC reporting will need to include information on country specific income and taxes, a list of companies by respective jurisdiction, main business activities, the number of employees, etc.

The CbC reporting must be filed within 12 months after the end of the ultimate parent's income tax year. With respect to the submission of master file and local files, the reform package includes changes to extend the due date for submission. Under the tax law changes, those files need to be submitted within 12 months from the end of each fiscal year. Previously, they had to be filed by the due date of filing annual corporate income tax return (i.e., within 3 months after the end of each fiscal year).

From 2018, the Korean tax authorities will exchange the CbC reports submitted according to the Multilateral Competent Authority Agreement on the Exchange of CbC reports (signed by Korea on June 30, 2016).

■ Extended Statute of Limitation for Tax Refund Request by Non-resident or Foreign Corporation

When a non-resident or a foreign corporation fails to apply for a reduced withholding tax rate allowed under the applicable income tax treaty, the non-resident or the foreign corporation may file a request for refund of overpaid withholding tax. Under the tax law changes, the statute of limitation for such tax refund request has been extended from 3 years to 5 years from the end of the month when tax was withheld.

II. Corporate Income Tax Law (CITL)

■ R&D Tax Credit for New Growth Engine Business and Core Technology

Under the tax law changes, the R&D tax credit for new growth engine businesses and core technologies has been reorganized with an increased focus on new technologies in 11 emerging industries such as future-generation motor vehicles, intelligent information, next-generation software and security, etc.

The R&D tax credit rate has increased for non-SMEs (small and midsize enterprises) from 20% up to 30% (depending on the R&D expenditure spent on new growth engine industries and core technologies). However, no change has been made to the existing 30% rate for SMEs.

The tax credit will be available in respect of expenses incurred for subcontracted or joint R&D activities with an expanded scope of organizations, which include domestic universities or colleges, public research organizations, domestic or foreign non-profit corporations (including laboratories affiliated with non-profit corporations), research organizations of domestic or foreign corporations, and industry technology research associations sponsored by government ministries.

■ Tax Credit for Facility Investment for Commercialization of New Growth Engine and Core Technology

The tax law changes include a new tax credit in respect of investment in facilities designed to promote commercialization of new growth engine or core technology (e.g., facilities for manufacturing of new drugs for which patents are obtained by a company based on clinical tests). The new incentive allows an investing individual or company to claim a credit at a certain percentage of its investment amount in such facilities against its individual or corporate income tax payable. The tax credit rate is 10% for SMEs, 7% for medium-scale companies and 5% for large corporations. Details on the qualifying facilities will be set forth in the Presidential Decree of the Special Tax Treatment Control Law (STTCL) through consultations with the relevant government ministries.

The new tax credit will be temporarily available for investments made on or after January 1, 2017 through December 31, 2018.

■ Reform of Foreign Investment Tax Exemption for High-Technology Businesses

Under the tax law changes, a comprehensive reform of the existing foreign investment tax exemption for high-technology businesses is as follows:

- Scope of businesses eligible for foreign investment tax incentives was reformed with a main focus on new growth engine industries (to be aligned with those which qualify for the foregoing R&D tax credit for new growth-engine industries).
- Tax exemption is based on the total tax base if the income from the business utilizing new growth engine technologies accounts for 80% or more of total tax base. Previously, the tax exemption was based on the proportion of the income from the qualifying high-tech business to total tax base.
- Tax exemption or reduction which was previously limited to 90% of the amount of foreign investment increases to 100% of the foreign investment amount.
- Foreign investors are subject to a new requirement for minimum investment.

■ Tax Incentives for Promotion of Cultural Contents

A tax credit has been adopted to promote production or development of cultural contents as follows:

A percentage of the expenses incurred to produce films, TV dramas (including animations) and documentary videos which may contribute to enhancing the national image, exports and tourism is claimed as a tax credit for individual or corporate income tax purposes with certain limits. Qualified production costs include original content acquisition costs, payment for actors/actresses (within 30% of the total domestic production costs), set production costs, editing costs, etc. However, they do not include indirect expenses for promotion, offshore production costs, government subsidies, etc. The tax credit rate is proposed to be 10% for SMEs, 7% for medium-scale companies and 3% for large corporations.

It will be temporarily available from January 1, 2017 through December 31, 2019.

■ Limitation on Utilization of Tax Loss of Foreign Corporation in Korea

Previously, the tax losses of a foreign corporation (i.e., a Korean branch of a foreign corporation) could be carried forward to the next ten years. While the tax losses carried over from prior years that can be utilized by a domestic company in a year are limited to 80% of the company's taxable income in the year, there was no limitation on the utilization of the tax losses of a foreign corporation. Under the tax law changes, a foreign company is subject to the limitation on the amount of the tax losses to be utilized by the foreign company on an equal footing with domestic companies.

■ Extended Due Date for Submission of Foreign Tax Credit Calculation Form

The deadline for submission of a foreign tax credit calculation form is in principle the due date for corporate income tax return filing. However, exceptionally in the event where a foreign government delayed in giving a notification showing the payment of foreign tax, an extension of 2 months was permitted from the date when such notification is received. Under the tax law changes, such extension of submission due date for the exceptional cases has been extended to 3 months to help enhance taxpayer's convenience.

■ Extension of Temporary Increase in Tax Deductible Limit for Entertainment Expenses

The tax limit for deductible entertainment expenses disbursed by SMEs have increased from KRW 18 million to KRW 24 million, effective until the end of December 2016. The tax law changes will extend this temporary increase in the tax limit by an additional two years until the end of December 2018.

■ Expanded Scope of Korean Sourced Personal Service Income of Non-resident or Foreign Corporation

Income derived by a non-resident or a foreign corporation from the following categories of personal services are subject to 22% withholding tax (including local income tax at 10% of the income tax amount) in Korea if such activities are performed in Korea: i) by an entertainer, a professional athlete or a freelancer; or ii) by those who have professional knowledge and skill regarding scientific technology, management and administration, etc. by utilizing relevant knowledge and skill.

Under the tax law changes, the income derived by a non-resident or a foreign corporation in respect of technical services performed outside Korea is treated as Korean sourced personal service income subject to Korean withholding tax if Korea's income tax treaty with a foreign country where the non-resident or the foreign corporation is a resident of allows taxation of the income in Korea (for example, the Korea-India income tax treaty). The withholding income tax rate will be set at 3% (exclusive of 10% local income tax (i.e., 0.3%) to be added on the income tax).

III. Individual Income Tax Law (IITL)

■ New progressive tax rate

Under the tax law changes, a new progressive tax rate has been adopted for the income bracket over KRW 500 million. We summarized the progressive tax rates (including local income tax rate) by income brackets as follows:

Before		Revised	
Taxable income	**Tax rates**	**Taxable income**	**Tax rates**
Up to W 12 million	6.6%	Up to W 12 million	6.6%
Over W 12 million and up to W 46 billion	16.5%	Over W 12 million and up to W 46 billion	16.5%
Over W 46 million and up to W 88 million	26.4%	Over W 46 million and up to W 88 million	26.4%
Over W 88 million and up to W 150 million	38.5%	Over W 88 million and up to W 150 million	38.5%
Over W 150 million	41.8%	Over W 150 million and up to W 500 million	41.8%
		Over W 500 million	**44.0%**

■ Changes in Preferential Tax Treatment on Foreign(Non-Korean) Workers

Under the tax law changes, there are changes regarding the preferential tax treatment on foreign expatriate employees working in Korea. The tax law change has extended the existing 5-year time limit for the application of the flat tax rate which is scheduled to sunset as of December 31, 2016 by additional 2 years so that the flat tax rate will apply to those who will start to work in Korea no later than December 31, 2018. The tax law changes also raised the flat tax rate from the current 17% to 19% (excluding local income tax).

■ New Exit Tax Adopted for Korean Residents Immigrating to a Foreign Country

Under the tax law changes, a new special tax treatment (so-called 'exit tax') is applicable to Korean residents who expatriate from Korea for reasons of immigration to a foreign country, etc. and satisfy all of the following conditions: i) having an address or domicile in Korea for at least five years during the 10-year period before the expatriation date, and ii) constituting a large shareholder subject to capital gains tax as prescribed in Article 157(4) of the Presidential Decree of the IITL.

The new exit tax will be assessed at the rate of 20% on the unrealized capital gains on the Korean shares held by the residents immigrating to a foreign country as if the shares are sold on the day the immigration takes place. Assets subject to exit tax may be expanded later depending on the enforceability of exit tax. The Korean residents subject to the exit tax is allowed to claim a foreign tax credit for the tax paid in a foreign country in case of actual share transfer or a tax credit where the value of shares at the time of actual transfer declines from the share price at the time of expatriation. The exit tax return filing together with the tax payment needs to be made within three months from the end of the month when expatriation takes place. In case of non-filing, a penalty of 20% of the tax payable will be imposed. The payment of exit tax may be deferred for five years if certain requirements are satisfied including the pledge of collateral to guarantee the tax payment and the designation of a tax agent in Korea. If an expatriate returns to Korea within five years from the expatriation date to declare a tax residency, the paid exit tax will be refunded.

The exit tax will apply to expatriations occurring on or after January 1, 2018.

IV. Penalties

■ Reduction in Penalties

Under the amended CITL and VAT Law provisions, penalties against the failure to comply with the tax filing and payment requirements has been reduced as follows:

Penalties	Before	Revised
Failure to submit statement for the change in shareholder	2% of par value of shares	**1%** of par value of shares
Failure to submit a payment statement	2% of payment amount (1% for late submission)	**1%** of payment amount (0.5% for late submission)
Failure to submit an aggregate statement for tax invoices or VAT invoices	1% of supply price (0.5% for late submission)	**0.5%** of supply price (0.3% for late submission)
Late receipt of VAT invoices (in case where input VAT deduction is claimed)	1% of supply price	**0.5%** of supply price

■ Deadlines of Tax Return Filing and Tax Payment for Corporate Income Tax and Local Income Tax

Under the CITL, a company having a fiscal year ended December 31, 2016 should file the FY2016 annual corporate income tax return before March 31, 2017.

In this connection, we summarized the due dates of tax return filing and tax payment related to corporate income tax and local income tax as follows:

In principle, annual/interim corporate tax income tax and local income tax returns are due filing together with tax payment as below:

Tax returns	Filing due dates
● Annual corporate income tax return	Within 3 months from the fiscal year-end
● Interim corporate income tax return	Within 2 months after the first 6 months of each fiscal year
● Annual local income tax return (assessed at 10% on corporate income taxes and the return should be filed with the district ku-office)	Within 4 months after the fiscal year-end (Installment is not applicable for local income taxes)

If the annual/interim corporation taxes payable are over Won 10 million, companies are allowed to make tax payments in 2 installments as below:

Tax returns	Payment due dates
● Annual corporate income tax return - 1st installment (*) - 2nd installment (*)	Within 3 months from the fiscal year-end Within 1 month from the end of the filing due date (within 2 months for a small and medium-sized company)
● Interim corporate income tax return - 1st installment (*) - 2nd installment (*)	Within 2 months from the fiscal year-end Within 1 month from the end of the filing due date (within 2 months for a small and medium-sized company)

(*) The amount of installments shall be determined as follows:

If total taxes payable is:		Installment payments can be broken down as below:
Over Won 10 million ~ up to 20 million	1st installment	10 million
	2nd installment	Excess over 10 million
Over Won 20 million	1st installment	50% or more of taxes payable
	2nd installment	Remaining 50% balance

■ Transfer Pricing and BEPS Requirements

Under the ITCL, which governs the taxation of international transactions between taxpayers and overseas specially related parties (OSRP), a company is obliged to submit the following documents for the transactions made with its OSRPs during the fiscal year to the relevant tax office together with its annual corporate income tax return:

- "Schedules of international transactions"
- "Report on Arm's Length Price Determination Method"
- "Summary Profit and Loss Statement of OSRP"

In addition, from FY2016, Multinational Enterprises (MNE) which meet the following conditions are also required to submit the Combined Report of International Transactions (CRIT) which is comprised of three elements (Local file, Master file, and CbC report).

CRIT	Local file and Master file	CbC report
Condition	Domestic corporations and foreign corporations with a domestic place of business that satisfy the following criteria: a. Annual gross sales of an individual entity exceed KRW100 billion; **and** b. International related party transaction exceeds KRW 50 billion per year.	Domestic (Korean) ultimate parent company of multinational enterprises with annual sales revenue exceeding KRW 1 trillion per consolidated financial statements for the preceding year
Due date	within 12 months from the end of each fiscal year (as revised from within 3 months from the fiscal year-end previously)	within 12 months from the end of each fiscal year

■ Year-end Settlement and Declaration of Payroll Withholding Taxes for 2016

The employer as a tax withholding agent must perform the year-end settlement of exact payroll withholding taxes for and on behalf of its employees in February of following year after each year end mandatorily as required by the IITL of Korea.

In this connection, the employer should reflect the results of year-end settlement in the February payroll of the following year accordingly. Any overpayment resulting from year-end settlement is used to offset the payroll taxes due in February of the following year and onward until fully utilized. For any underpayment resulting from the year-end settlement, the employer should withhold additionally from the February payroll and remit to the tax office as scheduled by March 10 of the following year.

For the year-end settlement processing, the employees should gather and submit supporting documents to claim tax deductions.

After the year-end settlement, employees having more than one source of income are required to file separately an annual income tax return for the year and pay taxes due on such income on or before May 31 of the following year (i.e. by May 31, 2017 for 2016 income).

Please contact any of the following individuals with any inquiries or comments.

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