

Newsletter

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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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■ Korea Signs Bilateral Agreement with the US for Automatic Exchange of Country-by-Country Reporting (CbCR)

The Ministry of Strategy and Finance announced that Korea and the US signed a bilateral agreement for an automatic exchange of Country-by-Country Reporting (“CbCR”) in the Netherlands on June 22, 2017. The agreement took effect from the following day on June 23, 2017.

CbCR is a form of reporting by multinational enterprises (MNE) initiated by the Organization for Economic Cooperation and Development (OECD) to improve tax transparency. A CbCR of a MNE group shall include information on the group’s global income, profits, assets, taxes paid in different jurisdictions, and other financial data. A CbCR shall be submitted to the tax authorities in the country where the headquarters reside and will be shared by other jurisdictions, which are signatories to bilateral or multilateral agreements for automatic exchange of CbCR. In June 2016, Korea signed the Multilateral Competent Authority Agreement on the exchange of CbCR which was concluded by 57 countries except the US.

Under the bilateral agreement, Korea and the US will automatically exchange CbCR information every year beginning from 2018. This will facilitate the exchange of information on business activities of MNEs to prevent offshore tax evasion.

■ Proposed Tax Law Changes in 2018

On August 2, 2016, the Ministry of Strategy and Finance has proposed the tax law changes to be implemented from 2018. The proposed tax law changes will be finalized after the National Assembly passes the bill. We summarized the major proposed tax law changes in 2018 to keep you updated as follows.

● Increase in Marginal Corporate Income Tax Rate to 25% for Tax Base Exceeding KRW 200 Billion

Under the proposal, the corporate income tax rate will increase to 25% for the tax base exceeding KRW 200 billion, effective for the fiscal year beginning on or after January 1, 2018. However, the tax rates applicable to the taxable income of KRW 200 billion or less will remain unchanged.

Currently, corporate income tax rates are 10% for the tax base not exceeding KRW 200 million, 20% for the tax base exceeding KRW 200 million but not more than KRW 20 billion, and 22% for the tax base exceeding KRW 20 billion.

Taxable income	Tax rates (*)	
	Current	Proposed
Up to KRW 200 million	10%	10%
Over KRW 200 million and up to KRW 20 billion	20%	20%
Over KRW 20 billion and up to KRW 200 billion	22%	22%
Over KRW 200 billion	22%	25%

(*) In addition to the corporate income tax, local income tax is assessed at 10% on corporate income tax liability separately.

● Limitation on Utilization of Tax Loss of Companies Other than Small and Midsize Enterprises

Currently, tax loss can be carried forward to the next ten years. The tax loss 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 (100% for small and midsize enterprise, 'SME').

Under the proposal, the 80% threshold for the companies other than SMEs will be gradually reduced to 60% for the fiscal year starting from January 1, 2018 and 50% for the fiscal year starting from January 1, 2019. However, the 100% threshold for SMEs will remain the same.

● Change to Special Tax Exemption for SMEs

Currently, SMEs engaging in one of 46 businesses including manufacturing are allowed to claim the special tax exemption at 5% ~ 30% of corporate income taxes calculated depending on the type of industry, corporate scale and company location.

The following changes are proposed to the special tax exemption:

- The tax exemption amount will be capped at KRW 100 million and the ceiling will be reduced by KRW 5 million per employee in the case where the number of employees is decreased. However, the tax exemption will be available for qualifying SMEs which also claim the tax credit for job creating investment and/or the tax credit for social security tax paid for an increase in regular employees. This revised tax exemption will apply for the year beginning on or after January 1, 2018 until December 31, 2020.
- In addition, the existing R&D credit rate for SMEs having qualifying R&D expenditures in new growth engine industries or core technologies as prescribed under the tax law will increase from 30% up to 40%.

● Increase in Marginal Individual Income Tax Rate

Under the proposal, the top marginal individual income tax rate will increase from 40% to 42%, while the individual income bracket of KRW 300 ~ 500 million will be subject to the tax rate of 40%. The individual income tax rates for the year beginning on or after January 1, 2018 will be as follows:

Taxable income	Tax rates (*)	
	Current	Proposed
Up to KRW 12 million	6%	6%
Over KRW 12 million and up to KRW 46 million	15%	15%
Over KRW 46 million and up to KRW 88 million	24%	24%
Over KRW 88 million and up to KRW 150 million	35%	35%
Over KRW 150 million and up to KRW 300 million	38%	38%
Over KRW 300 million and up to KRW 500 million	38%	40%
Over KRW 500 million	40%	42%

(*) In addition to the individual income tax, local income tax is assessed at 10% on individual income tax liability separately.

● Proposed New Rule to Reduce Interest Expense Deductions

The Korean thin capitalization rules disallow deduction of interest relating to the debt from an overseas controlling shareholder (and debt from a third party guaranteed by an overseas controlling shareholder) if the debt to equity ratio exceeds 2:1 (6:1 in case of financial institutions). The disallowed interest expense on the debt from a foreign controlling shareholder is further treated as dividends to the shareholder.

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Under the proposal, in line with recommendation of the Organization for Economic Cooperation and Development on the limitation of interest expense deductions (Action 4 of Base Erosion and Profit Shifting Project), the following new rules to restrict interest deduction on top of the existing thin capitalization rule will be introduced:

- The proposed rules will apply to the domestic company (including a Korean permanent establishment of a foreign corporation) having intercompany transactions with overseas related parties with the exceptions for banks and insurance companies.
- Net interest deduction claimed by a domestic company for the international transactions will be limited to 30% of the adjusted taxable income of the domestic company, meaning the interest expenses in excess of the 30% threshold will not be deductible.
 - The adjusted taxable income will be calculated by adding depreciation expense on fixed assets and net interest expense to the domestic company's taxable income.
 - The limitations will apply to the net interest expenses payable to overseas related parties (i.e. the amount of interest expense to be paid to overseas related parties minus the amount of interest income to be received from overseas related parties).
- In applying the existing thin capitalization rule and the new interest deduction rule, a domestic company should apply the rule which would result in a greater amount of nondeductible interest expense.

The proposed rules will be implemented from the fiscal year beginning on or after January 1, 2019.

● Increasing Penalty on Fictitious VAT Invoices

When a VAT invoice is wrongfully issued without supply of goods or services, which is called a fictitious VAT invoice, currently a penalty for issuing a fictitious VAT invoice is imposed at 2% of the supply price per the fictitious invoice.

Under the proposal, this penalty will increase to 3% of the supply price per fictitious VAT invoice. Also, if the supply price per VAT invoice is overstated, the penalty at currently 1% of the overstated supply price will increase to 2% if a taxpayer intentionally overstated the supply price.

This proposed rule will apply to the provision for products or service on or after January 1, 2018.

● Proposed Change to Korean Residency Test

A Korean resident is an individual who has an address in Korea or who is present in Korea for at least 183 days during the two (2) consecutive years. In order to promote inbound investment by Koreans living abroad, these residency criteria will be amended. Under the tax reform proposal, a Korean resident shall be an individual who has an address in Korea or who is present in Korea for at least 183 days during a year.

This proposed rule will be implemented from the fiscal year beginning on or after January 1, 2018.

● Proposed Changes for Tax Audit

To protect taxpayer rights in relation to tax investigations, currently the tax authorities must give taxpayers an advance notification of a periodic tax audit at least ten (10) days before the audit starts. In relation to the advance notification, the proposal includes the following changes:

- The advance notification must be given fifteen (15) days before the audit starts.
- In case of a partial tax audit, the scope of partial audit should be specified in the advance notification in addition to a reason for audit, investigation period, tax items to be audited, etc.
- If the advance notification is omitted in an exceptional case where the audit purpose cannot be achieved due to some reasons such as destruction of evidence, etc., a notification must be given to a taxpayer at the time of undertaking the audit. In this case, the notification should include the information to be specified in an advance notification and the reason for omitting the advance notification.
- The tax authorities will not be allowed to request a taxpayer to submit the information, which is not directly related to an audit. In this context, the tax authorities will not be allowed to request other records from a taxpayer if such records are not related to the types of taxes subject to an audit or computation of tax base and/or tax amount for the years subject to an audit.

The proposed changes will take effect from January 1, 2018.

■ Tax Tips

● Korean Value-Added Tax (VAT) Scheme

Here is a brief summary of the Korean VAT scheme and VAT return filing timelines for your future reference.

• Taxpayer subject to the VAT

A person who engages in supply of goods or services independently in the course of business, whether for profit or not, is subject to the VAT in Korea. Taxpayers including individuals, corporations, national and local governments, associations of local authorities, any bodies of persons, and unincorporated foundations of any other organizations are generally subject to the VAT.

• Taxable Period

The taxable period is divided into two:

- First period: January 1 through June 30
(Preliminary taxable period: January 1 through March 31)
- Second period: July 1 through December 31
(Preliminary taxable period: July 1 through September 30)

• Tax Return and Payment

- Preliminary Return and Payment

A taxpayer is required to file a return on the VAT base together with payment of the VAT amount payable (or claim of the VAT refundable) to the appropriate tax office within 25 days from the end of each preliminary return period; the first preliminary taxable period is from January 1 through March 31, and the second preliminary taxable period is from July 1 through September 30.

- Final Return and Payment

A taxpayer is required to file with the competent tax office a return on the VAT base together with payment of the VAT amount payable (or claim of the VAT refundable) in respect of each taxable period within 25 days after the end of the taxable period concerned.

- Submission of a summary of the VAT invoices

A taxpayer is required to submit the summary of the VAT invoices classified by customer for both output VAT and input VAT at the time of filing the preliminary returns and the final returns.

A taxpayer who issued electronic VAT invoices is required to submit electronically an electronic VAT

invoice list by the next day of issuing date.

- Filing and payment

Each business place should be registered with a district tax office, issue the VAT invoices, file the VAT return, and make VAT payment by each business place.

However, in the case where a taxpayer has two or more business places, the taxpayer may pay the entire VAT at the main business place by filing an application to the competent tax office having jurisdiction over the main business place.

Furthermore, if a taxpayer applies for the single taxpayer registration, its head office may register itself and its branches with its district tax office by a single tax registration number, and issue their VAT invoices with such single tax registration number. In this case, the head office can file the VAT return and make the VAT payment for itself and its branches.

● **Advance VAT Invoice Issuance**

Under Article 17 of the VAT law, a VAT invoice shall be issued at the date of the delivery of goods by a seller to a purchaser in general.

However, if the sales consideration is paid by the purchaser prior to the delivery timing and if the VAT invoice is issued for the portion of the sales consideration paid, such VAT invoice issued at the time of payment may be considered as a lawful VAT invoice ("Advance VAT Invoice" or "선세금계산서" in Korean).

To be deemed as a lawful VAT invoice, the Advance VAT Invoice should satisfy one of the following conditions:

- (i) the sales consideration is paid within 7 days from the VAT invoice issuance date; OR
- (ii) both of the following condition a. and b. are satisfied for the Advance VAT invoice:
 - a. The agreement entered into between the seller and the purchaser prescribes the fixed timing(s) of invoicing and of payment separately; **AND**
 - b. The period between invoicing and payment timing under contract is 30 days or shorter.

■ **Other Tips**

● **Employee Benefits Employers Need to Consider for Year-End Tax Settlement**

Companies may provide their employees with various employee benefits.

Some of these employee benefit items should be included into the taxable income of the employee concerned when the employer performs year-end income tax settlement for its employees as required under the tax law of Korea in February of following year after each year end.

Here is the list of major employee benefit items that you as an employer need to consider for year-end income tax settlement processing in Korea.

Employee Benefit	Eligibility and benefits
Meal allowance	Unless the company provides meals to its employees in in-house cafeteria or in other similar way, the meal allowances paid in cash to its employees shall be treated non-taxable up to Won 100,000 per employee per month. Any excess amount is fully taxable. A written policy is required for payment of meal allowance.

Car allowance/ reimbursement	If employees use their privately owned cars for business purposes and company pays its employees car allowances in accordance with the company's internal policy instead of reimbursement of actual costs incurred, car allowance is treated as non-taxable income of the employees up to KRW 200,000 per month. Any excess over KRW 200,000 is treated as taxable income for employees. Employee should submit the car registration certificate under his name to the company.
Gifts (cash or non-cash) paid to employee	Gifts given to employee for birthday or holiday (e.g., New Year's day, Thanksgiving Day, summer vacation, etc.) are taxable in principle and subject to tax. However, if the amount is within the social norm, such gifts can be treated as non-taxable as allowed under the tax law of Korea. If the amount is excessive, we recommend that you treat the amount as taxable earned income in a conservative stance.
Education/Employee Training for employee himself	For training related expense reimbursement to the employee, such costs can be posted to employee benefits and do not need to be included as part of the taxable earned income to the employee concerned for tax purposes if such reimbursement is i) related to the employer's business, ii) reimbursed in accordance with the employer's work rule and iii) returned to the employer if he/she fails to work, after completion of the education/training program, for the months equivalent to the education/training period in case the length of such period is 6 months or longer.
Education/tuition support for employee's children	The tuition support (for junior high/high school/college education for dependent children) should be treated as taxable income to the employee concerned and thus shall be included in the taxable gross salary for tax purposes in Korea. The employee may claim deduction of such expenses at year-end settlement. A company may issue payment to the employee(s) directly, but for tax calculations, such reimbursed amount should be included in the monthly salary report.
Gym membership or healthcare support allowance	Gym membership or healthcare support allowance/benefit should be added to the employee's taxable salary income.
Stock option/Stock based compensation /ESPP/RSU	Income of employees from the Stock Based Compensation should be taxed at the time when the Stock Based Compensation is vested for the individual earned income tax purpose. Tax reporting requirements will be different depending on whether the company bears the related cost or not (Class A vs. Class B income classification).
Medical check-up for employee	The Company shall provide regular medical checkup for all Employees once every calendar year (once every two years for those who work mainly in the office) as required under the Industrial Safety and Health Act of Korea. The medical check-up cost designated by the Enforcement Decree of Ministry of Employment and Labor and the Industrial Safety and Health Act of Korea paid by the company is not taxable income to the employee concerned. However, the medical check-up cost paid over and above the amount under these regulations is taxable income to the employee concerned.
Group term life insurance	For the group term insurance (purchased by the company for the benefit of its employee) to be treated as non-taxable for up to a maximum of KRW 700,000 per year to the employees, such group term insurance should satisfy the following conditions: a. the insurance money is to be paid upon an employee's death, injury or disease b. the insured and beneficiary are employees c. the paid-in premiums are not refundable at its maturity (referred to as "group genuine indemnity insurance") or the paid-in premiums are refundable only within the limit not exceeding the paid-in premiums at its maturity (referred to as "group refund-cum-guaranty insurance")
Housing allowance	Housing allowance will be treated as non-taxable income only if: a. the company provides the employees with the house, which was rented or owned by the company, at low price or no cost; and b. the lease payment should be made to the landlord directly.

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

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