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

Proposed Tax Law Changes for 2016

Proposed Tax Law Changes for 2016

On August 6, 2015, the Ministry of Strategy and Finance has announced tax law changes to be implemented from 2016. The proposed tax law changes will be finalized after the National Assembly passes the bill. We summarized the major proposed tax law changes for 2016 to keep you updated as follows:

■ BEPS / Transfer Pricing Documentation Requirements Strengthened

In July 2013, the Organization for Economic Cooperation and Development ("OECD") and G20 countries adopted **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 proposed 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 proposed revision to the International Tax Coordination Law ("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) which would address management information and current status of cross-border transactions of the MNE. To be specific, the following information should be included in the comprehensive report on cross-border transaction information:

Description	Main contents
Report I (Master file)	● Comprehensive legal ownership structure and location of subsidiaries or offices of the MNE ● Details of top 5 goods or services covering 5% of MNE group's revenue ● Explanation on major business restructuring, share acquisition, sale of business, etc.
Report II (Local file)	● 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

Once the proposed bill is sanctioned by the National Assembly, MNE's tax reporting burden would increase considerably going forward.

■ **Limitation on Deductible Company Vehicle-related Expenses**

Under the current Corporate Income Tax Law ("CITL"), expenses incurred in relation to vehicles used for business purposes of a company (including depreciation, rental fee, fuel expense, insurance, maintenance expense, car tax, toll fee, etc.) are allowed to be fully deducted for the corporate income tax purposes, while concerned input value added tax ("VAT") incurred cannot be claimed as a credit on its VAT returns under the VAT Law. With the proposed revision, however, the below additional requirements should be satisfied for the company vehicle-related expenses to be treated as tax deductible expenses.

If certain conditions are met (e.g., subscription of insurance policy for business purposes which allows only directors/employees of the company to drive the vehicles, reporting of the company vehicles used for business purposes to the district tax office, etc.),
(1) a certain ratio (e.g., 50%) of the expenses are allowed to be tax deductible, but if an actual usage ratio of the vehicles for business purposes are proved through a daily driving log, etc., the actual usage ratio will be applicable; OR
(2) when the company's logo is attached to the vehicles (other than that in a detachable form), 100% of the expenses will be allowed to be tax deductible.

If the conditions mentioned above are not met, the entire company vehicle-related expenses shall be denied for tax deduction. Discussions are also being made among politicians to set the price limit of the car which can be used for business purpose (i.e., if a car value exceeds certain limit, any expenses related to such car will not be tax deductible).

Temporary Cut in Individual Consumption Tax Rates for 2015

Temporary Cut in Individual Consumption Tax Rates for 2015

A taxpayer who sells or takes taxable goods including automobiles and home appliances out of the place of manufacture should file Individual Consumption Tax return by the 25th of the following month after each quarter-end together with tax payment.

Recently, the Ministry of Strategy and Finance has announced that Individual Consumption Tax will be cut temporarily on automobiles and home appliances by 30 percent from August 27, 2015 to December 31, 2015.

As a result of this Individual Consumption Tax cut, consumers who plan on newly purchasing automobiles or large home appliances (such as air conditioners, refrigerators, washers, televisions, etc.) are expected to enjoy a lower price being subject to 3.5% of consumption tax, compared to the previous tax rate of 5%.

Tax Tips - FAQ

■ Value Added Tax (VAT) Scheme

Taxpayer subject to the VAT

A person who engages in the 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 period: January 1 through March 31)
- Second period: July 1 through December 31
  (Preliminary 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 and the VAT amount payable (or 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 and the VAT amount payable (or 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 return and the final return.

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 on a business place basis.

  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 with 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 will file the VAT return and make the VAT payment for itself and its branches.

■ Retirement Pension Plan in Korea

Under the Korean Labor Standards Act (LSA) and the Employee Retirement Benefit Security Law (ERBSL), an employer with five or more employees shall be allowed to convert the current lump-sum severance pay scheme to retirement pension scheme where an employee may receive retirement benefits in the form of pension. Under the retirement pension scheme, employees will receive pension benefits when they reach the age of 55 and certain amount of contribution has been deposited each month in a financial institution for 10 years or more.

In the case where a company changes from the existing severance pay scheme to the retirement pension scheme or makes changes in retirement pension scheme that are less beneficial to its employees, the company is required to obtain a consent from the majority of the employees in advance.

Retirement pension scheme is external funding schemes in which an employer deposits amount needed for severance payment to an external financial institution before employee's resignation or termination, and the external financial institution pays retirement benefits to resigned or terminated employees in a lump-sum or annuity.

Companies can select either Defined Benefit ("DB") plans and/or Defined Contribution ("DC") plans under the consent of the majority of employees. The following table summarizes the characteristics of DB and DC plans:

Description	DB type	DC type
Required reserve amounts	more than 60% of the total employees' severance benefit	more than 1/12 of the latest annual salary
Risk bearer & beneficiary (*)	employer	employee
Retirement benefit	30 day average salary x service period	Varies depending on investment performance
Payment	annuity or lump-sum	

(*) Bearing responsibility of fund operation results.

According to the Korean GAAP, to recognize expenses during service periods, statutory severance pay provisions should be fully accrued at the end of each fiscal year. On the other hand, under the CITL, the statutory severance pay provision can be deducted only up to a certain percentage of the estimated statutory severance pay, which was 10% of the estimated statutory severance pay for FY2014. This deductible limit will be decreased by 5% each year down to a zero % in 2016. From FY2016, the statutory severance pay provisions will not be allowed as deductible expenses' for corporate income tax purposes. Therefore, to enjoy additional tax deduction, contribution to a retirement pension plan can be considered.

From corporate tax perspective, a company can minimize corporate tax payment by contributing towards the retirement pension plan and taking benefit of tax deduction for corporate income tax purpose. However, such benefit is only a timing difference, and over the span of whole employment period, the tax burden will eventually be the same as the disallowed severance pay provision will eventually be captured at termination of employee and allowed as deductible expenses for corporate income tax purposes.

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