Crowe

한울회계법인
Hanul Choongjung LLC

Newsletter

September 2018

Bi-monthly Newsletter of Hanul Choongjung LLC

Smart decisions. Lasting value.

Contents

- Proposed South Korean Tax Law Changes in 2019
  <International Taxation>
  - Extended income tax exemption for qualifying foreign (non-Korean) engineers
  - Embrace OECD standards in connection with international taxation
  - Reduced tax credit allowed to Class B earned income taxpayers reporting through the Class B taxpayers association
  - Expanded scope for electronic services of foreign (non-Korean) company subject to VAT
  - Extended statute of limitation on tax assessment for cross-border transactions
  - Strengthened exit tax
  - Strengthened reporting requirement for overseas real estate and overseas direct investment

  <Other Items of Interests>
  - Expanded tax credit and carryover period for donations
  - Increased dividend received deduction rate for the holding company
  - Eased taxpayers' burdens by reduced penalties, etc.
  - Reduced scope of business buyer's secondary tax liability
  - Introduced right for audio recording during tax audit

- Tax Planning Tips
  - Income tax reduction benefit for youth employees of small and medium enterprises (SME) in Korea
  - Flat tax rate benefit available to foreigner(non-Korean) expatriate employees and its time limit

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 South 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.

Hanul Choongjung LLC is a member of Crowe Global, a Swiss verein. Each member firm of Crowe Global is a separate and independent legal entity. Hanul Choongjung LLC and its affiliates are not responsible or liable for any acts or omissions of Crowe Global or any other member of Crowe Global. Crowe Global does not render any professional services and does not have an ownership or partnership interest in Hanul Choongjung LLC.

© 2018 Hanul Choongjung LLC

■ Proposed South Korean Tax Law Changes in 2019

On July 30, 2018, the Ministry of Strategy and Finance (MOSF) of Korea announced the government tax reform proposals to be implemented from 2019. The proposed tax law changes will be finalized after the National Assembly passes the bill. We summarized the major proposed tax law changes in 2019 to keep you updated as follows.

< International Taxation >

● Extended income tax exemption for qualifying foreign (non- Korean) engineers

Under the proposals, in order to attract more foreign engineers into the country, the tax exemption period for qualifying foreign engineers currently for 2 years will be extended to 5 years. It shall apply to those who enter into an employment contract between January 1, 2019 to December 31, 2021.

When the tax exemption is applied, 50% of wages received by foreign engineers would be exempt from individual income tax in Korea. In order to apply for tax exemption, a foreign engineer shall be providing services under technology inducement agreements or shall work as a research staff in qualifying R&D centers of foreign-invested companies in Korea. In addition, the R&D centers should have: (i) more than 5 regular researchers with a bachelor's degree in the natural sciences with at least three years of R&D experience or with a master's degree in the natural sciences, (ii) an independent research facility, (iii) research facility investment of KRW 100 Million or more, and (iv) more than 30% of foreign ownership.

● Embrace OECD standards in connection with international taxation

(1) Repeal of individual and corporate tax exemptions for foreign direct investment

The proposals would repeal the existing individual and corporate income tax exemptions for foreign-invested companies in Korea for the sake of fair taxation between domestic and foreign capital.

The current law grants corporate and individual income tax exemption for 5 to 7 years to foreign-invested companies engaging in the new growth sector businesses and in specially designated areas such as foreign investment zones, free economic zones and free trade zones.

The proposals will be effective for tax incentive applications filed on or after January 1, 2019. The repeal has no effect on local (provincial) tax and indirect tax. Therefore, the tax exemption from acquisition tax and property tax on property acquired and owned by the foreign-invested companies for up to 15 years will continue to apply. And also, the tax exemption from customs duties, VAT and individual consumption tax on imported capital goods by the foreign-invested companies for up to 5 years will continue to apply.

(2) Expanded scope of foreign companies’ permanent establishment (PE) in Korea and expanded scope of dependent agent

Under the current Korean tax law, the PE of a foreign company in Korea shall not include a fixed place used solely for: (i) the purposes of purchasing goods or merchandise for the foreign company; (ii) the purposes of storing goods or merchandise belonging to the foreign company; and (iii) the purposes of maintaining a stock of goods or merchandise belonging to the foreign company for processing by another company.

The proposals add that the above exemption applies only if the activity of such fixed place is limited to a preparatory or auxiliary nature. This revision intends to reflect the contents of revised OECD Model Tax Convention in November 2017 in line with the BEPS initiatives and will be effective from the fiscal year beginning on or after January 1, 2019.

Under the proposals, a person or a company may be deemed to be a dependent agent of a non-resident or a foreign company in Korea if a person or a company habitually conclude contracts, or habitually plays

a principal role leading to the conclusion of contracts that are routinely concluded by the non-resident or the foreign company without material modification even if a person or a company has no legal authority to conclude contracts on behalf of the non-resident or the foreign company.

Through the existence of such dependent agent in Korea, a non-resident or a foreign company can be deemed to have a PE in Korea and such PE shall be taxed in Korea in the same manner as a Korean company in most aspects.

The proposals clarify the types of contracts that are considered to establish a deemed dependent agent status, which include contracts concluded (i) in the name of a foreign company, (ii) to transfer ownership of, or to grant the right to use of, property owned by a foreign company, or (iii) to provide services of a foreign company.

This revision intends to expand taxation of domestic source income of a non-resident or a foreign company doing business in Korea directly or indirectly, and will be effective from the fiscal year beginning on or after January 1, 2019.

In this respect, foreign companies doing business in Korea, especially in a form of liaison office, branch office or through an agent, are strongly recommended to carefully review current business structure in connection with the expected foregoing changes and reflect in the business plans in advance to avoid any possible disputes with the Korean tax authority in the future.

● Reduced tax credit allowed to Class B earned income taxpayers reporting through the Class B taxpayers association

Currently when a taxpayer who has wage and salary income received from an overseas employer in foreign currency reports his/her earned income through the Class B taxpayers association and is being withheld income taxes on a monthly basis, such taxpayer is eligible for a 10% tax credit.

Under the proposals, this tax credit will be reduced from 10% to 5%. This revision will apply to wage and salary income earned on or after January 1, 2019.

● Expanded scope for electronic services of foreign (non-Korean) company subject to VAT

Currently if a foreign (non-Korean) company not having a permanent establishment (PE) in Korea provides electronic services (e.g., games, sounds, video files, electronic documents, software, etc.) to an individual or a company in Korea (except for provision of electronic services to an individual or a company who is registered for VAT purposes in Korea) and receives compensation from such customers, the non-Korean company should apply for a special VAT registration to the Korean tax authorities. The proposals expand the scope of electronic services to include “cloud computing” of foreign (non-Korean) companies. The cloud computing is defined as the services of renting storage space in central computer connected to internet, software stored in central computer, etc.

This revision will be applied to the cloud computing services provided on or after July 1, 2019.

● Extended statute of limitations on tax assessment for cross-border transactions

Current	Proposed Changes
■ Current statute of limitation • Fraud or other fraudulent acts: 15 years • Non-reporting: 7 years • Under-reporting: 5 years	■ Cross-border transaction concept is introduced and the statute of limitation period is extended: • Fraud or other fraudulent acts: 15 years • Non-reporting: **10 years** • Under-reporting: **10 years**

To improve the effectiveness of taxation on overseas tax evasion, the proposals newly expand the range of cross-border transactions to include transactions of overseas assets or services made between residents of Korea. In addition, the statute of limitation on tax assessment for cross-border transactions will be extended from 7 years for non-reporting and 5 years for under-reporting to 10 years for both. This revision will be effective for the transactions of which tax liabilities accrue on or after January 1, 2019.

- **Strengthened exit tax**

Currently the exit tax is applied by 20% of deemed capital gain to a major shareholder of a domestic corporation who moves from Korea to a foreign country for a reason of immigration, etc.

To prevent overseas tax evasion and secure the right to taxation on domestic property, the exit tax will be newly applied to a major shareholder of a corporation holding excessive real estate assets where 50% or more of its assets is composed of real estate (80% for golf course or ski resort company). In addition, the progressive tax rate scheme will be introduced at 20% on the tax base of KRW 300 million or less and 25% on the tax base exceeding KRW 300 million.

To improve the effectiveness of the exit tax, a penalty will be newly imposed by 2% on face value of the shares which are non-reported or under-reported. Any major shareholder subject to exit tax shall report the details of shareholding as of one day before the filing due date which is one day before departure.

Above revisions will be applied to the immigrants from Korea to foreign country on or after January 1, 2019.

- **Strengthened reporting requirement for overseas real estate and overseas direct investment**

<table>
<tr><th colspan="3">Current</th><th colspan="3">Proposed Changes</th></tr>
<tr><td colspan="3">■ Domestic companies or individuals who acquired foreign real properties or have rental(lease) income are subject to reporting requirement:</td><td colspan="3">■ Strengthened reporting requirements and penalty assessment standards.
• Disposal of overseas real properties are newly added and the base amount threshold by transaction is newly introduced.</td></tr>
<tr><td></td><td>Reporting required</td><td>Base amount threshold</td><td></td><td>Reporting required</td><td>Base amount threshold</td></tr>
<tr><td>Acquisition</td><td>Acquisition details</td><td>N/A</td><td>Acquisition</td><td>Acquisition details</td><td rowspan="2">Acquisition value of over KRW 200 million</td></tr>
<tr><td>Rental(lease) income</td><td>Rental (lease) income detail</td><td>N/A</td><td>Rental(lease) income</td><td>Rental (lease) income detail</td></tr>
<tr><td colspan="3"><added></td><td>Disposal</td><td>Disposal details</td><td>Disposal value of over KRW 200 million</td></tr>
<tr><td colspan="3">■ Penalties for delinquent reporting and false reporting</td><td colspan="3">■ Increased penalties</td></tr>
<tr><td colspan="2"></td><td>Penalties</td><td colspan="2"></td><td>Penalties</td></tr>
<tr><td colspan="2">For acquisition</td><td>1% of acquisition value</td><td colspan="2">For acquisition</td><td>10% of acquisition value</td></tr>
<tr><td colspan="2">For rental(lease) income</td><td>1% of acquisition value</td><td colspan="2">For rental(lease) income</td><td>10% of rental(lease) income</td></tr>
<tr><td colspan="3"><added></td><td colspan="2">For disposal</td><td>10% of disposal value</td></tr>
<tr><td colspan="3">※ Max penalty limit: KRW 50 million</td><td colspan="3">※ Max penalty limit: KRW 100 million</td></tr>
</table>

In an effort to strengthen management of offshore tax bases by the Korean tax authorities, the proposals

expand the reporting requirement to include details on disposal of overseas real estate by domestic companies or individuals in the annual income tax returns. This revision will be effective from the filings for the overseas real estate for the tax year beginning on or after January 1, 2019. For the increased penalties, the revisions will be effective from the tax years beginning on or after January 1, 2020.

< Other Items of Interests >

● Expanded tax credit and carryover period for donations

Current	Proposed Changes
■ Current threshold for donation tax credit • Up to KRW 20 million: 15% • Over KRW 20 million: 30%	■ Reduced threshold for higher tax credit rate bracket: • Up to **KRW 10 million**: 15% • Over **KRW 10 million**: 30%

To promote donation activities for individuals, the proposals expand the tax credit amount for donations by reducing the threshold for 30% tax credit rate bracket. Currently, a 15% tax credit is applied for donations up to KRW 20 million and a 30% tax credit is applied for donations over KRW 20 million for individuals. Based on the proposals, a 30% tax credit will be applied for donations over KRW 10 million for individuals. This revision will be effective for the tax returns filed on or after January 1, 2019.

In addition, the carryover period for donations, currently 5 years, will be extended to 10 years for both individuals and companies. This revision will be effective for the donations disbursed on or after January 1, 2013.

● Increased deduction rate on dividend received for the holding company

To encourage the holding companies to increase their shareholding ratio over subsidiaries, deduction ratio on the dividend received (DRD rate) for the holding companies are proposed to be increased as below:

This revision will be effective for the dividend received by the holding companies on or after January 1, 2019.

Current		
Shares of holding company		DRD Rate
Listed	Unlisted	
Over 40%	Over 80%	100%
20% to 40%	**40% t0 80%**	**80%**
Less than 20%	Less than 40%	30%

Proposed		
Shares of holding company		DRD Rate
Listed	Unlisted	
Over 40%	Over 80%	100%
30% to 40%	**50% to 80%**	**90%**
20% to 30%	**40% to 50%**	**80%**
Less than 20%	Less than 40%	30%

● Eased taxpayers' burdens by reduced various penalties.

To ease taxpayers' burdens related to tax payment and tax withholding requirement, the proposals include reduction of various penalties which will be, in general, effective on or after January 1, 2019.

● Reduced scope of business buyer's secondary tax liability

Under the proposals, the secondary tax liability in a comprehensive business transfer transaction will be applied only to certain buyers who meet the following conditions:

(1) The buyer is a related party of the seller, or
(2) The buyer acquired the business to assist the seller's tax evasion.

This revision will be applied to a business transfer made on or after January 1, 2019.

- **Introduced right for audio recording during tax audit**

To reinforce taxpayers' right during tax audit, under the proposals, a tax auditor and a taxpayer will be allowed to have an audio recording during tax audit. If a tax auditor intends to have an audio recording, the auditor needs to notify the taxpayer of the audio recording in advance and provides a taxpayer with copy of the audio recording file at the taxpayer's request. This revision will be effective from January 1, 2019.

■ Tax Panning Tips

- **Income tax reduction benefit for youth employees of small and medium enterprise ('SME') in Korea**

Previously, in case where a youth prescribed by the Special Tax Treatment Control Law of Korea (STTCL), a person aged 60 or older, a person with disability, or a career-interrupted female was employed by a SME, such employee was entitled to income tax reduction in the amount equivalent to 70% of income tax.

Under the amended STTCL that came into force earlier this year in May 2018 and additionally very recently in August 2018, the tax reduction benefit for youth employees has been expanded as summarized below.

	Before amendment	After amendment
Employees eligible for this income tax reduction benefit	Youth employees aged 29 or younger, employees aged 60 or older, employees with disability, and career-interrupted female employees who are hired between Jan 1, 2012 and Dec 31, 2018	Youth employees aged **34 or younger**, employees aged 60 or older, employees with disability, and career-interrupted female employees who are hired between Jan 1, 2012 and Dec 31, 2018 (or **Dec 31, 2021 for youth employees**)
Income Tax Reduction Rate	70% (up to KRW 1.5 mil max limit for each taxable period)	70% (**90% for youth employees**) (up to KRW 1.5 mil max limit for each taxable period)
Reduction period	3 years from the original date of hire	3 years from the original date of hire (**5 years for youth employees**)

For youth employees who are aged 34 or younger, the income tax reduction benefit shall be applied for 5 years from the date of original hire and this 5-year extended reduction period shall be applicable to youth employees who are hired no later than December 31, 2021.

These amended STTCL provisions that came into force in 2018 shall apply only prospectively from the 2018 earned income of youth employees whose service period at an SME is less than 5 years.

- **Flat tax rate benefit available to foreigner(non-Korean) expatriate employees and its time limit**

Under the Individual Income Tax Law of Korea, the individual income tax liabilities of foreign workers on earned income from the rendering of his/her services to companies in Korea including foreign invested companies can be finalized by applying the 20.9% flat tax rate (including 1.9% of local income tax) on gross earned income for the first five (5) year period notwithstanding Article 55 (1) of the Individual Income Tax Law (IITL) of Korea (*Article 18-2, STTCL*). Foreigners who have already been working in Korea as at Jan 1, 2014 will be eligible for the 20.9% flat tax rate limited to the taxable year ending December 31, 2018.

As such, depending on the employee's first start date of work in Korea, the foreign employee shall be eligible for flat rate application with limited time period as explained below.

Depending on the first start date of work in Korea:	**Time limit of flat tax rate application will be determined as below:**
• If a foreigner(non-Korean) employee was working in Korea **as at Jan 1, 2014** (regardless of whether the employee was applied the flat tax rate before or after Jan 1, 2014)	Eligible to be applied the flat tax rate only **up to Dec 31, 2018.**
• If the employee started working in Korea **after Jan 1, 2014**	Eligible to be applied the flat tax rate **for 5 years** counting from the start year of work in Korea.

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

KS Han, J W Choi, G S Sim, or S Y Lee *at Tax & BPO Services*

Hanul Choongjung LLC
Member Crowe Global
Sindo Building, 10th Floor, 14 Teheran-ro 88-gil,
Gangnam-gu, Seoul 06179, Korea
TEL: (82)(2) 316-6600   FAX: (82)(2) 775-5885
E-mail: post@crowe.kr
Website: http://www.crowe.kr

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