

Tax Alert

South Korea

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On July 30, the Ministry of Strategy and Finance (MOSF) of Korea announced the government's 2018 tax reform proposals. The reform proposals include tax incentives for qualifying foreign engineers and changes in line with OECD standards such as BEPS (base erosion and profit sharing). The proposals will be finalized by the end of 2018 after deliberation by the National Assembly.

Provided below is a summary of key tax reform proposals which we believe shall affect foreign companies doing business in Korea on or after January 1, 2019.

■ 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 Won 100 Million or more, and (iv) more than 30% of foreign ownership.

■ Embrace OECD Standards in connection with International Taxation

● 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.

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The current law grants a 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.

- **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.

This tax alert is prepared and issued by Hanul Choongjung LLC and intended to timely provide foreign investors with an update on tax law changes in Korea. 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.

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

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