

Newsletter

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This newsletter is prepared and issued by Hanul LLC in Seoul, Korea 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.

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■ Korean Tax Law Changes in 2019

Proposed tax law changes announced by the Korean government in July 2018 were approved by the National Assembly in December 2018 with several amendments and additions. We summarized below some of the major tax law changes for 2019 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, 2019 unless indicated otherwise.

I. Special Tax Treatment Control Law (STTCL)

● Repeal of individual and corporate tax exemptions for foreign direct investment

The tax law changes have repealed individual and corporate income tax exemptions for foreign-invested companies in Korea for the sake of fair taxation between domestic and foreign capital.

Previously, the foreign-invested companies which meet certain conditions were granted corporate and individual income tax exemption for 5 to 7 years provided that the foreign-invested companies engaged in the new growth sector businesses or invested in specially designated areas such as foreign investment zones, free economic zones and free trade zones.

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 eligible foreign-invested companies for up to 15 years would continue to apply. And also, the tax exemption from customs duties, VAT and individual consumption tax on imported capital goods by the eligible foreign-invested companies for up to 5 years would continue to apply.

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

Under the tax law changes, in order to attract more foreign engineers into the country, the tax exemption period for qualifying foreign engineers currently for 2 years would 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.

II. Corporate Income Tax Law (CITL)

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

Previously, the PE of a foreign company in Korea did 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 tax law changes have added that the above exemption shall apply only if the activity of such fixed place is limited to a preparatory or auxiliary nature. This change intends to reflect the contents of the revised OECD Model Tax Convention in November 2017 in connection with the BEPS.

Under the tax law changes, 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.

The changes also 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.

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.

III. Individual Income Tax Law (IITL)

- **Reduced tax credit allowed to Class B earned income taxpayers reporting through a Class B taxpayers' association**

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

Under the tax law changes, this tax credit has been reduced from 10% to 5%.

- **Strengthened exit tax**

Previously, the exit tax was 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.

Under the tax law changes, to prevent overseas tax evasion and secure the right to taxation on domestic property, the exit tax has been newly applied to a major shareholder of corporation with excessive real estate where at least 50% of the assets is composed of real estate (80% for a golf course or ski resort company). In addition, the progressive tax rate scheme has been 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 has been 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 changes have been applied to the immigrants from Korea to a foreign country on or after January 1, 2019. However, the tax rate increase on the small and medium enterprise (SME) shares has been postponed for one year and will take effect to the immigrants from Korea to a foreign country on or after January 1, 2020.

IV. Others

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

Previously, if a foreign (non-Korean) company not having a PE in Korea provided 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 received compensation from such customers, the non-Korean company should apply for a special VAT registration to the Korean tax authorities. The changes have expanded the scope of electronic services to include advertising, brokerage and “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.

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

Current	Proposed Changes
<ul style="list-style-type: none"> ■ Previous statute of limitation <ul style="list-style-type: none"> • Fraud or other fraudulent acts: 15 years • Non-reporting: 7 years • Under-reporting: 5 years 	<ul style="list-style-type: none"> ■ Cross-border transaction concept is newly introduced and the statute of limitation period is extended: <ul style="list-style-type: none"> • Fraud or other fraudulent acts: 15 years • Non-reporting: 10 years • Under-reporting: 7 years

To improve the effectiveness of taxation on overseas tax evasion, the tax law changes 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 have been extended from 7 years for non-reporting and 5 years for under-reporting to 10 years for non-reporting and 7 years for under-reporting, respectively.

■ **Year-End Settlement and Declaration of Payroll Withholding Taxes for 2018 (due filing by March 11, 2019)**

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 it to the tax office as scheduled by March 10 of the following year (by March 11, 2019 for year 2018).

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

By the year-end settlement and filing, employees having only salary income may fulfill his/her annual individual income tax reporting obligations in Korea. On the other hand, employees having other source of income than salary income are required to file additionally an annual individual income tax return together with tax payment on or before May 31 of the following year additionally (i.e., by May 31, 2019 for 2018 income).

■ **Major Changes in 2018 Year-End Settlement of Payroll Withholding Taxes**

- **Top marginal tax rate raised to 46.2% for the highest tax bracket of over KRW 500 million tax base**

(Korean Won)

2017		2018	
Tax Base	Tax Rate	Tax Base	Tax Rate

Up to 12 Million	6%	Up to 12 Million	6%
Over 12 Million - 46 Million	15%	Over 12 Million - 46 Million	15%
Over 46 Million – 88 Million	24%	Over 46 Million – 88 Million	24%
Over 88 Million – 150 Million	35%	Over 88 Million – 150 Million	35%
Over 150 Million – 500 Million	38%	Over 150 Million – 300 Million	38%
Over 500 Million	40%	Over 300 Million – 500 Million	40%
		Over 500 Million	42%

(*) Local (provincial) income tax shall be added at 10% of the income tax liability, top marginal income tax rate being 46.2%.

● **Tax credit rate increased for monthly housing rent depending on annual salary level**

2017		2018	
Annual Salary	Tax Credit Rate	Annual Salary	Tax Credit Rate
KRW 70 Million or less	10%	KRW 55 Million or less	12%
Over KRW 70 Million	Nil	Over 55 Million – 70 Million	10%
		Over 70 Million	Nil

● **Income deduction for credit card, etc. expanded for use on books or performance expenditures**

2017	2018
Income deduction for credit card use, etc. <ul style="list-style-type: none"> o Deductible amount: Excess credit card use amount over 25% of gross salary income o Deduction rates: <ul style="list-style-type: none"> - Credit cards: 15% - Debit cards: 30% - Traditional markets/public transportation: 40% o Max deduction: KRW 2 Million - 3 Million <ul style="list-style-type: none"> - Additional KRW 1 Million for traditional markets or public transportation use o Effective up to 12/31/2018 	Deduction rate increased for use on traditional market and public transportation and additional deduction for use on books or performance expenditures <ul style="list-style-type: none"> o Same o Deduction rates: <ul style="list-style-type: none"> - Same - Same - Same - Books and performance expenditures (defined) (applicable only to employees having annual gross salary of less than KRW 70 Million: 30% o Same <ul style="list-style-type: none"> - Additional KRW 1 Million for books or performance expenditures for employees having annual gross salary of less than KRW 70 Million o Extended up to 12/31/2019

● **Income tax reduction benefit expanded for youth employees of an SME in Korea**

Previously, in case where a youth defined under the STTCL, a person aged 60 or older, a person with disability, or a career-interrupted female was employed by an 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 last year in May 2018 and additionally 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 <u>29 or younger</u> , 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 initial date of hire	3 years from the initial date of hire (5 years for youth employees)

For youth employees who are aged 34 or younger, income tax reduction benefit shall be applied for 5 years from the date of initial 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 2018 earned income of youth employees whose service period at an SME is less than 5 years.

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

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