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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 in 2017**Proposed Tax Law Changes in 2017**

On July 28, 2016, the Ministry of Strategy and Finance has announced tax law changes to be implemented from 2017. The proposed tax law changes will be finalized after the National Assembly passes the bill. We summarized the major proposed tax law changes in 2017 to keep you updated as follows:

■ R&D Tax Credit for New Growth Engine Business and Core Technology

Several changes are proposed to reorganize the existing R&D tax credit for new growth engine businesses and core technologies. One of the proposed changes is to adjust the eligible scope with an increased focus on new technologies in 11 emerging industries such as future-generation motor vehicles, intelligent information, next-generation software and security, etc. Currently, the R&D tax credit is available for 75 categories of technologies in 12 new growth engine industries and 50 types of technologies in 17 core technology areas. Details of qualifying technologies and industries will be specified in the Presidential Decree of the Special Tax Treatment Control Law (STTCL).

It is also proposed to increase the R&D tax credit rate for non-SMEs (small and midsize enterprises) from 20% up to 30% (depending on the R&D expenditure spent on new growth engine industries and core technologies). However, no change is proposed to the existing 30% rate for SMEs.

In addition, the tax credit for expenses incurred for R&D activities subcontracted or performed jointly is currently allowed for the R&D activities subcontracted to or performed jointly with qualifying R&D centers, R&D-dedicated departments of a company or R&D service businesses. The tax credit will be available in respect of expenses incurred for subcontracted or joint R&D activities with an expanded scope of organizations. They will include domestic universities or colleges, public research organizations, domestic or foreign non-profit corporations (including laboratories affiliated with non-profit corporations), research organizations of domestic or foreign corporations, and industry technology research associations sponsored by government ministries.

■ Tax Credit for Facility Investment for Commercialization of New Growth Engine and Core Technology

It is proposed to allow a tax credit in respect of investment in facilities designed to promote commercialization of new growth engine or core technology (e.g., facilities for manufacturing of new drugs for which patents are obtained by a company based on clinical tests). The proposed new incentive will allow an investing individual or company to claim a credit at a certain percentage of its investment amount in such facilities against its individual or corporate income tax payable. The tax credit rate is proposed to be 10% for SMEs, 8% for medium-scale companies and 7% for large corporations. Details on the qualifying facilities will be set forth in the Presidential Decree of the STTCL through consultations with the relevant government ministries.

To enjoy the new tax credit, the following conditions must be met: i) a company's total R&D expenditure must represent at least 5% of total sales and the proportion of R&D expenditure relating to new growth engine or core technology must satisfy certain criteria to be specified by the Presidential Decree; and ii) a company must not reduce the number of regular employees from the preceding year.

The proposed tax credit will not be available for investment in a designated metropolitan area (e.g., Seoul). In addition, the tax credit claimed will be recaptured in the cases where: i) a company reduces the number of regular employees within a period of two years following the year the tax credit is claimed (i.e., KRW 10 million per employment reduced); ii) an entire amount of the tax credit will be recaptured if the qualifying facilities are used for purposes other than the authorized use of commercialization in three years from the date when the investment is completed.

The proposed tax credit will be temporarily available for investments made on or after January 1, 2017 through December 31, 2018.

■ Reform of Foreign Investment Tax Exemption for High-Technology Businesses

A comprehensive reform of the existing foreign investment tax exemption for high-technology businesses is proposed as follows:

- The scope of businesses eligible for foreign investment tax incentives (which currently include 497 types of high-technology business and 153 types of industry-supporting service business) will be reformed with a main focus on new growth engine industries (to be aligned with those which qualify for the foregoing R&D tax credit for new growth-engine industries).

- Currently, the tax exemption is based on the proportion of the income from the qualifying high-tech business to total tax base. Under the proposal, the tax exemption will be based on the total tax base if the income from the business utilizing new growth engine technologies accounts for 80% or more of total tax base.
- **The tax exemption or reduction which is currently limited to 90% of the amount of foreign investment (i.e., 50% based on the investment amount and 40% based on the employment) will increase to 100% of the foreign investment amount (i.e., 50% based on the investment amount and 50% based on the employment).**
- **A foreign investor will be subject to a new requirement for minimum investment.**
- The eligible scope of new growth engine technologies will be decided through consultations with respective committees as specified by the Presidential Decree instead of government ministries.

■ Tax Incentives for Promotion of Cultural Contents

A tax credit will be introduced to promote the production or development of cultural contents as follows:

A percentage of the expenses incurred to produce films, TV dramas (including animations) and documentary videos which may contribute to enhancing the national image, exports and tourism will be claimed as a tax credit for individual or corporate income tax purposes with certain limits. Qualified production costs will include original content acquisition costs, payment for actors/actresses (within 30% of the total domestic production costs), set production costs, editing costs, etc. However, they will not include indirect expenses for promotion, offshore production costs, government subsidies, etc. The tax credit rate is proposed to be 10% for SMEs and 7% for non-SMEs.

It will be temporarily available from January 1, 2017 through December 31, 2019.

■ Extension of Temporary Increase in Tax Deductible Limit for Entertainment Expenses

The tax limit for deductible entertainment expenses disbursed by SMEs have increased from KRW 18 million to KRW 24 million, effective until the end of December 2016. A proposed change will extend this temporary increase in the tax limit by an additional two years until the end of December 2018.

■ **Reduction in Penalties**

It is proposed to reduce penalties against the failure to comply with the tax filing and payment requirements as stipulated as follows:

Penalties	Current	Proposed
Failure to submit statement for the change in shareholder	2% of par value of shares	1% of par value of shares
Failure to submit a payment statement	2% of payment amount (1% for late submission)	1% of payment amount (0.5% for late submission)
Failure to submit an aggregate statement for tax invoices or VAT invoices	1% of supply price (0.5% for late submission)	0.5% of supply price (0.3% for late submission)
Late receipt of VAT invoices (in case where input VAT deduction is claimed)	1% of supply price	0.5% of supply price

■ **Enforcement of Improper Solicitation and Graft Act (Effective from Sep 28, 2016)**

Enforcement of Improper Solicitation and Graft Act (Effective from Sep 28, 2016)

The “Improper Solicitation and Graft Act” (more commonly known as “Kim Young-Ran Act”) will come into force starting September 28, 2016 as the bill passed the plenary session of the National Assembly on March 3, 2015.

As this Act is expected to impact all businesses and individuals in Korea, we summarized the key aspects of this Act for your special attentions as follows:

- **What are the background and objectives of this Act**

The bill was first proposed in August 2012 by Kim Young-Ran, a former Supreme Court Justice and then Head of the Anti-Corruption & Civil Rights Commission (ACRC), to overcome the limitations of the existing anti-corruption laws such as the Criminal Act, the Public Service Ethics Act, etc. The purpose of the Act is to establish a more advanced corruption prevention system by setting codes of conduct and ethics standards of public officials to live up to the global standards such as the OECD guidelines.

As the non-compliance with the requirements stipulated in this Act may trigger criminal punishment and resultant fines, penalties, etc., which are not tax deductible, companies or individuals who are dealing with or doing business with the public sector must plan properly to avoid any non-compliance issues.

• **Who will be subject to this Act**

Organizations	<ul style="list-style-type: none"> • All the public institutions including constitutional institutions, central administrative agencies, local governments, municipal/provincial offices of education, and public service-related organizations • Private and public schools, and media companies
Individuals	<ul style="list-style-type: none"> • Public officials or relevant persons: Civil servants of national or local governments, heads and employees of public service-related organizations, public institutions, schools, educational corporations, and media companies • Spouses of public officials • Private persons performing public duties: Individuals participating in the decision-making process of public organizations • General public: Persons who improperly solicit public officials or who offer them prohibited financial or other advantages

• **Which acts constitute improper solicitations and reporting process required**

Definition of improper solicitations	<ul style="list-style-type: none"> • No one should solicit, directly or through a third party, a public official or relevant person performing duties. • A total of 15 types of improper solicitations are stipulated to explicitly explain which acts constitute the acts of improper solicitation. • A total of seven exceptions to improper solicitations including an act of requesting certain actions in public are stipulated, in order to prevent people from being discouraged to duly exercise their rights
Reporting and handling process of improper solicitation	<ul style="list-style-type: none"> • If a public official or relevant person receives an improper solicitation, he should clearly express an intention to refuse the solicitation, and report the fact to the head of the concerned agency if such solicitations repeatedly occur.

• **What are prohibited as acceptance of financial or other advantages**

Unacceptable financial or other advantages and sanctions	<ul style="list-style-type: none"> • A public official or relevant person should be subject to criminal punishment if he receives financial or other advantage in excess of KRW 1 million at a time or KRW 3 million in a fiscal year from the same person, <u>regardless of his duties or the title of such offer.</u> • A fine for negligence will be imposed when a public official receives financial or other advantages not exceeding KRW 1 million <u>if the acceptance is in connection with his duties.</u>
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Prohibition of acceptance of financial or other advantages by the spouse of a public official	<ul style="list-style-type: none"> • The spouse of a public official or relevant person should not receive financial or other advantages that are in connection with the duties of the public official or relevant person. • A public official will face sanctions <u>if he or relevant person knew the fact that his spouse received unacceptable financial or other advantages, but did not report it.</u>
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- **Disciplinary Actions and Punishments**

Disciplinary actions may be taken along with punishment or fine for negligence.

<Improper solicitation>

Violations	Sanctions
A stakeholder who improperly solicits a public official through a third party	Fine for negligence not exceeding KRW 10 million
A person who improperly solicits a public official for a third party (Private person)	Fine for negligence not exceeding KRW 20 million
A public official who improperly solicits another public official for a third party	Fine for negligence not exceeding KRW 30 million
A public official or relevant person who performs his duties as directed by an improper solicitation	Imprisonment for not more than two years or by a fine not exceeding KRW 20 million

<Graft>

Violations	Sanctions
<p><u>Fine for negligence for the receipt of a financial or other advantage not exceeding KRW 1 million</u></p> <p>A public official who received a financial or other advantage not exceeding KRW 1 million in connection with his duties, regardless of whether such offer is given in exchange of any favors</p> <p>* A public official who does not report the financial or other advantage received by his spouse</p> <p>* A person who provided a financial or other advantage to a public official or his spouse</p>	<p>Fine for negligence in the amount of two times to up to five times the received amount</p>
<p><u>Criminal punishment for the receipt of a financial or other advantages in excess of KRW 1 million at a time or KRW 3 million in a fiscal year</u></p> <p>A public official who receives a financial or other advantage in excess of KRW 1 million at a time or KRW 3 million in a fiscal year from the same person, regardless of his duties or the title of him</p> <p>* A public official who does not report the financial or other advantage received by his spouse</p> <p>* A person who provided a financial or other advantage to a public official or his spouse</p>	<p>Imprisonment for not more than 3 years or by a fine not exceeding KRW 30 million</p>

■ Tax Tip
– Interest
deduction and
thin
capitalization
rules

Tax Tip – Interest deduction and thin capitalization rules

Interest incurred in the normal operation of an enterprise is deductible as long as the related loan is used for business purposes. However, exceptions exist for interest incurred relating to borrowings for non-business purposes and construction.

Interest paid on loans from the foreign (non-Korean) controlling shareholder which controls in substance the Korean entity concerned ("Loans") or loans guaranteed by the foreign controlling shareholders ("Guarantees") will be non-deductible under the 2 to 1 rule (6 to 1 rule for financial institutions) and treated as dividend income to the shareholder subject to withholding of income taxes. However, exceptions exist when a taxpayer meets certain conditions stipulated under relevant laws.

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