

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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■ Tax Law Changes in 2018

Proposed tax law changes announced by the government in August 2017 were approved by the National Assembly in December 2017 with several amendments and additions. We summarized below some of the major tax law changes for 2018 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, 2018 unless indicated otherwise.

I. International Tax Coordination Law (ITCL)

■ Thin Capitalization - Introduction of New Rule to Reduce Interest Expense Deductions

The Korean thin capitalization rules disallow deduction of interest relating to the debt from an overseas controlling shareholder (and debt from a third party guaranteed by an overseas controlling shareholder) if the debt to equity ratio exceeds 2:1 (6:1 in case of financial institutions). The disallowed interest expense on the debt from a foreign controlling shareholder is further treated as dividends to the shareholder.

Under the tax law changes, in line with recommendation of the Organization for Economic Cooperation and Development on the limitation of interest expense deductions (Action 4 of Base Erosion and Profit Shifting Project), the following new rules to restrict interest expense deduction on top of the existing thin capitalization rule have been introduced:

- The new rules apply to the domestic company having intercompany loans with overseas related parties with the exceptions for banks and insurance companies.
- Net interest deduction claimed by a domestic company for the international loans will be limited to 30% of the adjusted taxable income of the domestic company, meaning the interest expenses in excess of the 30% threshold will not be deductible.
 - The adjusted taxable income will be calculated by adding depreciation expense on fixed assets and net interest expense to the domestic company's taxable income.
 - The limitations will apply to the net interest expenses payable to overseas related parties (i.e., the amount of interest expense to be paid to overseas related parties minus the amount of interest income to be received from overseas related parties).
- In applying the existing thin capitalization rule and the new interest expense deduction rule, a domestic company should apply the rule which would result in a greater amount of nondeductible interest expense.

The new rules shall be effective from the fiscal year beginning on or after January 1, 2019.

II. Corporate Income Tax Law (CITL)

■ Increase in Marginal Corporate Income Tax Rate to 25% for Tax Base Exceeding KRW 300 Billion

Under the tax law changes, a new progressive tax rate has been adopted for the tax base exceeding KRW 300 billion. However, the tax rates applicable to the taxable income of KRW 300 billion or less will remain unchanged.

Taxable income	Tax rates (*)	
	Previously	Revised
Up to KRW 200 million	10%	10%
Over KRW 200 million and up to KRW 20 billion	20%	20%
Over KRW 20 billion and up to KRW 300 billion	22%	22%
Over KRW 300 billion	22%	25%

(*) In addition to the corporate income tax, local(provincial) income tax is assessed at 10% on corporate income tax liability separately.

■ Limitation on Utilization of Tax Loss of Companies Other than Small and Mid-sized Enterprises

Under the Korean tax law, the tax loss can be carried forward to the next ten years. Previously, the tax loss carried over from prior years that can be utilized by a domestic company in a year was limited to 80% of the company's taxable income in the year (100% for small and mid-sized enterprises; "SME").

Under the tax law changes, the 80% threshold for the companies other than SMEs has been gradually reduced to 70% for the fiscal year starting from January 1, 2018 and 60% for the fiscal year starting from January 1, 2019. However, the 100% threshold for SMEs will remain the same.

■ Change to Special Tax Exemption for SMEs

Previously, SMEs engaging in one of 46 businesses including manufacturing were allowed to claim special tax exemption at 5% ~ 30% of corporate income taxes calculated depending on the type of industry, corporate scale and company location.

The following changes have been made to the special tax exemption:

- The tax exemption amount shall be capped at KRW 100 million and the ceiling shall be reduced by KRW 5 million per employee in the case where the number of employees is decreased. However, the tax exemption will be available for qualifying SMEs which also claim tax credit for job creating investment and/or the tax credit for social security tax paid for an increase in regular employees. This revised tax exemption will apply for the year beginning on or after January 1, 2018 until December 31, 2020.

■ Reduction in R&D Tax Credit Rate for Large Corporations

Under the tax law changes, the R&D tax credit for large corporations has been reorganized with an increased focus on expanding equality of taxation and securing corporate income tax base.

In this regard, the following changes have been made to the R&D tax credit for large corporations:

- The existing R&D credit rate, which applied to the portion of R&D expenses incurred in current year exceeding R&D expenses incurred in the immediately preceding year, has decreased from 30% to 25%.
- In addition, the existing 1% of base R&D credit rate, which was applied regardless of the ratio of the R&D expenses to the revenue for the current year, was abolished.

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

Under the tax law changes, the R&D tax credit for new growth engine businesses and core technologies has been reorganized.

The R&D tax credit rate has increased for SMEs from 30% up to 40% (depending on the R&D expenditure spent on new growth engine industries and core technologies). Also, the R&D tax credit rate of 25% to 40% has been newly adopted for medium-scale companies listed on KOSDAQ.

The tax credit will be available in respect of expenses incurred for subcontracted or joint R&D activities with an expanded scope of organizations, which 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.

■ Introduction of Tax Credit for Social Insurance Premiums for New Participants

Under the new law, in case where employees who are hired by SMEs as of January 1, 2018, newly participate in social insurance by December 31, 2018, SMEs can claim tax credit amounting to 50% of the insurance premiums paid by the SMEs for 2 years.

III. Individual Income Tax Law (IITL)

■ Increase in Marginal Individual Income Tax Rate

Under the tax law changes, the top marginal individual income tax rate has increased from 40% to 42%, while the individual income bracket of KRW 300 ~ 500 million is subject to the tax rate of 40%. The individual income tax rates for the year beginning on or after January 1, 2018 are as follows:

Taxable income	Tax rates (*)	
	Previously	Revised
Up to KRW 12 million	6%	6%
Over KRW 12 million and up to KRW 46 million	15%	15%
Over KRW 46 million and up to KRW 88 million	24%	24%
Over KRW 88 million and up to KRW 150 million	35%	35%
Over KRW 150 million and up to KRW 300 million	38%	38%
Over KRW 300 million and up to KRW 500 million	38%	40%
Over KRW 500 million	40%	42%

(*) In addition to the individual income tax, local(provincial) income tax is assessed at 10% on individual income tax liability separately.

■ Revised Korean Residency Test

Previously, a Korean resident was defined as an individual who has an address/domicile in Korea or who is present in Korea for at least 183 days during the two (2) consecutive years. In order to promote inbound investment by Koreans living abroad, these residency criteria were amended. Under the revised law, a Korean resident shall be an individual who has an address/domicile in Korea or who is present in Korea for at least 183 days during a year.

This amended rule shall be implemented from the fiscal year beginning on or after January 1, 2018.

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■ Non-Taxation of Gain from Stock Option Exercise for Employees and Executives of Venture Companies

Under the tax law changes, in order to encourage infusion of talent into venture companies (defined), gain from stock option exercise up to KRW 20 million is excluded from taxation, if all of the following conditions are met:

- a. Taxpayers should be employees/executives of venture companies; and
- b. Stock options should be granted on or before December 31, 2020.

■ Non-Taxation of Capital Gains from Disposal of Unlisted Stocks on Korea Over The Counter Market

Generally, capital gains from transferring stocks of unlisted companies constitute taxable income of the shareholders. Under the tax law changes, in order to stimulate trading of unlisted stocks on Korea Over The Counter (“K-OTC”) market, certain capital gains from transferring unlisted stocks on K-OTC market are excluded from taxation, if all of the following conditions are met:

- a. Stock transfers are made by the minority shareholders; and
- b. Transferred stocks are stocks of SMEs or medium-scale companies other than large corporations.

■ Tax Exemption on Payments Received from Performance Compensation Fund for Core Personnel of Medium-Scale Companies

Under the tax law changes, certain mutual aid payments received from the Performance Compensation Fund are exempt from individual income tax, if all of the following conditions are met:

- a. Taxpayers should be employees of medium-scale companies;
- b. Employees and medium-scale companies should join a mutual aid program on or before December 31, 2018; and
- c. Employees should pay contributions for at least 5 years.

When employees receive mutual aid payments, the endowment paid by the companies are subject to income tax, however, eligible for 30% tax exemption.

IV. Others

■ Increase in Penalty on Fictitious VAT Invoices

Under the amended VAT Law provisions, in case where a VAT invoice is wrongfully issued without supply of goods or services (which is called a “fictitious” VAT invoice), a penalty for issuing a fictitious VAT invoice shall be imposed at 3% of the supply price per the fictitious invoice. Also, if the supply price per VAT invoice is intentionally overstated, 2% of the supply price per VAT invoice shall be imposed as the penalty.

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■ Changes for Tax Audit

To protect taxpayer rights in relation to tax investigations, previously the tax authorities had to give taxpayers an advance notification of a periodic tax audit at least ten (10) days before the audit starts. In relation to the advance notification, the following changes have been made:

- The advance notification must be given fifteen (15) days before the audit starts.
- In case of a partial tax audit, the scope of partial audit should be specified in the advance notification in addition to a reason for audit, investigation period, tax items to be audited, etc.
- If the advance notification is omitted in an exceptional case where the audit purpose cannot be achieved due to some reasons such as destruction of evidence, etc., a notification must be given to a taxpayer at the time of undertaking the audit. In this case, the notification should include the information to be specified in an advance notification and the reason for omitting the advance notification.
- The tax authorities will not be allowed to request a taxpayer to submit the information which is not directly related to an audit. In this context, the tax authorities will not be allowed to request other records from a taxpayer if such records are not related to the types of taxes subject to an audit or computation of tax base and/or tax amount for the years subject to an audit.

The changes take effect from January 1, 2018.

■ Addition of qualified suspension reason of statute of limitation period for national tax collection right

The Korean tax authorities' right to collect national taxes shall be extinguished by prescription, if it is not exercised for either of the following periods from the time it is exercisable:

- National taxes of KRW 500 million or more : 10 years
- National taxes other than those prescribed above : 5 years

Meanwhile, the statute of limitation (extinctive prescription) shall not run during certain periods prescribed in the National Tax Basic Law, such as period for installment tax payment, period for deferment of tax collection, period for suspending disposition of tax in arrears. From January 1, 2018, if a delinquent taxpayer stays abroad for more than 6 months, the statute of limitation (extinctive prescription) shall not run during that period.

■ Specification on items to be considered when selecting taxpayers for periodic tax audit based on the periodic compliance analysis of the National Tax Service

Prior to the tax law changes, when the Commissioner of the National Tax Service acknowledges that a taxpayer is suspected to be non-compliant based on the periodic compliance analysis of the taxpayer's tax returns, tax authorities could select the taxpayer for periodic tax audit. From January 1, 2018, it is clearly stated that in evaluation of taxpayer's compliance, not only taxpayer's tax information such as tax filing but financial audit opinion should be considered.

■ Social Insurance Changes in 2018

The government recently passed the proposed changes in Enforcement Decrees of Employment Insurance Act, Industrial Accident Compensation Insurance Act, etc. in its Cabinet Meeting held on December 19, 2017. The major changes can be summarized as below that can be of special interests to foreign companies doing business in Korea and domestic companies alike.

■ Increase in Benefits for Reduced Working Hours during Child Care Period

When a worker parenting his/her children aged 8 years or younger reduces working hours for child care, he/she is eligible to receive benefits for reduced working hours during the period of child care. From January 1, 2018, benefits for reduced working hours during the period of child care have increased to 80% from previous 60% of the ordinary monthly wage in proportion to the reduced working hours (max KRW 1,500,000, min KRW 500,000).

This change shall apply to workers who reduced working hours for child care starting from January 1, 2018.

■ Increase in Maximum Amount of Maternity Leave Pay

Employers shall grant a female employee who is pregnant a total of 90-day maternity leave before and after childbirth. In such cases, at least 45 days of the leave period after childbirth shall be allowed. Also, the Minister of Employment and Labor shall pay maternity leave benefits to the female employee who has been granted maternity leave. Maternity leave benefits shall be payable in an amount equal to the employee's ordinary monthly wage during maternity leave, however capped at KRW 4.8 million effective from January 1, 2018 (increased from KRW 4.5 million in 2017).

■ Increase in Daily Maximum Unemployment Insurance Pay

The daily maximum unemployment insurance pay is increased from KRW 50,000 to KRW 60,000 in consideration of the minimum wage increase in Korea. This increased daily maximum unemployment insurance pay shall be applicable to workers who are laid off from jobs on or after January 1, 2018.

■ Subsidies for Employment of Seniors Aged 60 or More

Currently businesses which employ more than certain threshold of the seniors aged at least 60 or more are eligible for government subsidies for employment of seniors aged 60 or more (threshold varies by industry). The provision which was set to expire as of December 31, 2017 will remain effective until December 31, 2020. The amount of quarterly subsidies is as follows:

Fiscal Year	Amount
2018	KRW 240,000 per eligible senior employee
2019	KRW 270,000 per eligible senior employee
2020	KRW 300,000 per eligible senior employee

■ **Clarification on definition of ordinary commute related accidents**

Under the Korean Industrial Accident Compensation Insurance Act, any accident that occurs while an employee commutes to or from work using a transportation means provided by employers or other similar means under the control and management of employers is deemed an occupational accident that are covered by the Industrial Accident Compensation Insurance in Korea. In addition, from January 1, 2018, accidents occurred during commutes using ordinary routes and manners are also considered an occupational accident.

Generally, if accidents occurred in deviation from ordinary routes and manners, they cannot meet the definition of an occupational accident. However, if it is determined that the deviation from ordinary routes and manners are necessary to carry out the daily life of the employees as listed out below, any accidents resulting from such acts shall still be allowed as occupational accident.

- Purchase of necessities
- Participation in education, training in connection with employees' duties
- Exercise of rights to vote
- Nursing, treatment, school run of family members

■ **Increase in Minimum Wage**

Under the revised Labor Standards Act, the minimum hourly wage has risen from KRW 6,470 to KRW 7,530. This change took effect from January 1, 2018.

■ **Revision to Minimum Level of Reserves under Defined Benefit Retirement Pension Plans**

Previously, the minimum level of reserves had to be maintained at least at 80% of the standard policy reserve. Revised minimum level of reserves under the revised Enforcement Regulation of the Employee Retirement Benefit Security Law (ERBSL) shall increase as follows:

Period	Minimum Level of Reserves
For the period from January 1, 2018 to December 31, 2018	80%
For the period from January 1, 2019 to December 31, 2020	90%
From January 1, 2021	100%

■ **Year-end Settlement and Declaration of Payroll Withholding Taxes for 2017 (due filing by March 12, 2018)**

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 to the tax office as scheduled by March 10 of the following year (by March 12, 2018 for year 2017).

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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 (i.e. by May 31, 2018 for 2017 income).

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

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