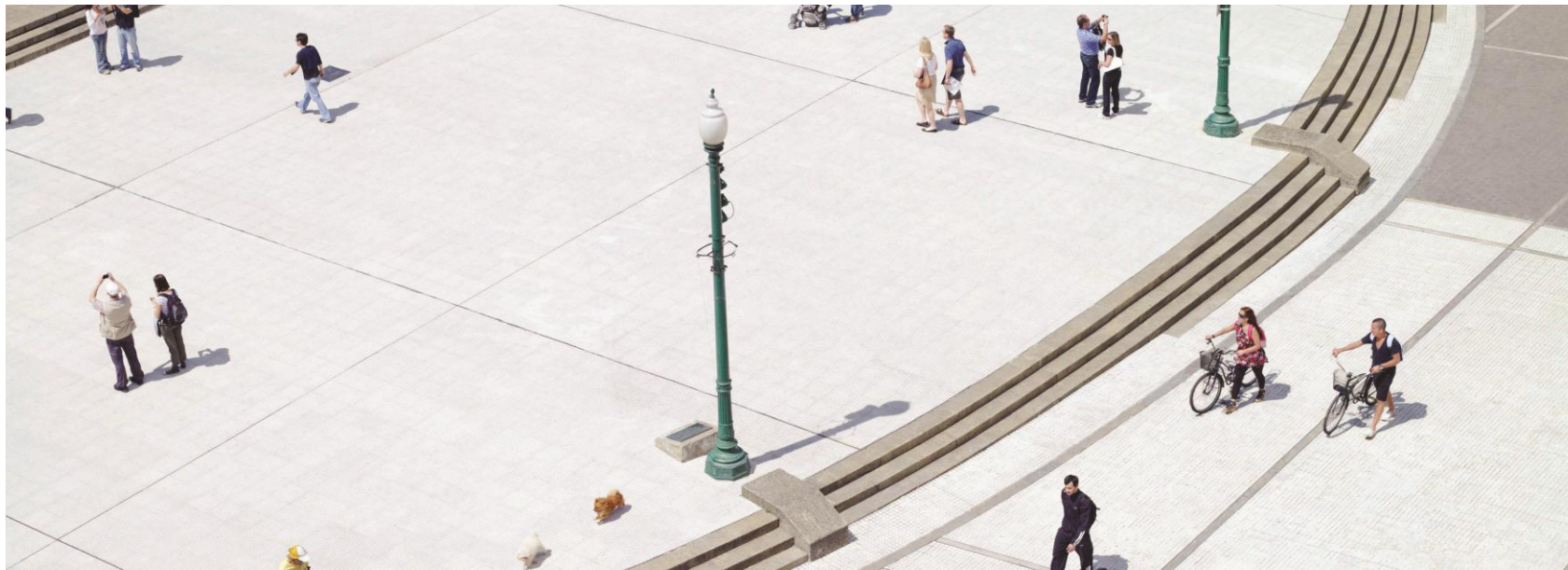


Tax News Flash

Korean Tax Law Changes for 2015

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Tax Law Changes for 2015

The National Assembly has recently approved bills to amend eight series of tax laws including the Corporate Income Tax Law and the Value Added Tax Law with some modifications to the government's reform proposals announced by the Ministry of Strategy and Finance last August (for coverage of the reform proposals, see Samil PwC Tax Newsflash, August 6 2014 issue). In a subsequent measure, the Ministry has released bills to amend the Enforcement Decrees providing details related to the changes contained in the recently approved tax laws. The proposed Enforcement Decrees will be made public for comments until January 16, 2015 and can be subject to minor modifications finalized before being proclaimed at the end of January 2015. Most of the changes recently approved or

contained in the proposed Enforcement Decrees will become effective from January 1, 2015 unless otherwise be specified.

A brief summary of the approved tax laws and key points of the proposed Enforcement Decrees are provided below.



Corporate Income Tax Law

Additional surtax to facilitate the use of corporate retained earnings in facility investment and increases in payroll and dividend payments

In order to motivate corporations to utilize corporate retained earnings to fund facility investment, wage increases and dividend payments, the amended Corporate Income Tax Law (CITL) introduces a 10% additional levy on corporate income if the use of such earnings falls short of a certain portion of corporate net income for the concerned year. Major points of the additional levy under the amended CITL include:

- The additional levy shall apply to companies with net equity in excess of KRW 50 billion (excluding SMEs) and companies belonging to business groups subject to restrictions on cross-shareholdings under the Act on Monopoly Regulation and Fair Trade.
- Regarding the method of charging the additional levy, companies may elect one of the following methods and cannot revoke its election for three consecutive years:
 - i) (taxable income (*note 1) for the year x a given rate – the total amount of investment (*note 2), payroll increases and dividend payments) x 10%; or
 - ii) (taxable income for the year x a given rate – the total amount of payroll increases and dividend payments) x 10%

The proposed Enforcement Decree of the CITL sets forth details related to the addition levy:

- The given rates will be 80% in (i) and 30% in (ii);
- The taxable income in (*note 1) shall be adjusted for certain items. Examples of add-backs to taxable income include dividends received from subsidiaries, interest income received on refunds of overpaid national taxes and the amount of depreciation expenses incurred in facility investments made in the current year. Examples of deductions from taxable income include corporate taxes (excluding this surtax), tax loss carried forwards, statutory reserve transfers, disallowed donations, etc.;
- The scope of investment in (*note 2) will include tangible and intangible fixed assets for business use. Investments made to build new or additional business buildings and purchase the relevant building site, machinery and equipment, vehicles, tools, patents, trademarks, mining rights, and developments costs will be included in the scope of investment. However, overseas investment and investments made to acquire equity will be excluded from the scope of investment for these purposes.

Corporate Income Tax Law

Changes to Foreign Tax Credit Rules

Three significant changes related to foreign tax credit are contained in the amended CITL and the proposed Enforcement Decree of the CITL. All these changes will become effective on January 1, 2015 or immediately after the amended rules are proclaimed.

- **Foreign tax credit limitation:** The maximum foreign tax credit that can be claimed by a Korean taxpayer is computed by the following formula: Calculated Korean tax amount x foreign source taxable income minus expenses / worldwide taxable income. In calculating the credit limit, there are two options at present. Taxpayers may compute the limit by reference to the foreign source taxable income received from each foreign jurisdiction. Alternatively, the limit can be computed by aggregating all foreign source taxable income received from all foreign jurisdictions. Under the proposed Enforcement Decree, only the first option is allowed and the second option will be abolished. Any existing excessive credit amount shall be carried over for five years and be allocated and subject to each foreign jurisdiction limit.

- **Indirect foreign tax credit:** Foreign taxes paid on dividends received from overseas subsidiaries of a domestic parent may be used as a foreign tax credit or as a deduction in calculating the domestic company's corporate income tax payable. The scope of overseas subsidiaries eligible for the indirect foreign tax credit will be limited to only include subsidiaries in which the domestic parent holds directly 25% or more of the shares. The current threshold is 10%. In addition, the existing indirect foreign tax credit will no longer be granted to dividends indirectly received from foreign grandchild subsidiaries. .
- **Extended submission deadline:** The foreign tax credit calculation statement must be in principle filed when filing a corporation tax return or a personal income tax return. In exceptional cases (e.g. due to a delay in a foreign jurisdiction's assessment, reassessment or notice, etc.), this statement may be filed within two months (rather than 45 days at present) from the date when a foreign jurisdiction's assessment notice or etc. is received.

Reduction in penalty for the extension of corporate tax return filing

If a corporation is forced to apply for the one month extension of the deadline (i.e., within 3 months from the fiscal year-end) to file a corporate income tax return because the external audit is not completed, the penalty rate will be reduced from 10.95% to 2.9% per annum of the late paid tax amount.

Penalty for Non-Compliance with Reporting Requirement of Overseas Property Holding

For the failure to comply with the requirement for submitting details on overseas property holdings, the penalty will increase to the smaller of the amount equivalent to 1% of the acquisition price or KRW 50 million, rather than the originally proposed penalty of up to KRW 10 million.

Special Tax Treatment Control Law

Employees Covered by a New Tax Credit for Increase in Corporate Payroll

The amended Special Tax Treatment Control Law (STTCL) introduces a temporary 10% tax credit (5% for large corporations) on the incremental amount in average corporate payroll over a certain base level calculated in a prescribed manner by taking into account the average corporate payroll over the previous three years. This is conditional on there being no decline in the number of full-time employees from the previous year. The proposed Enforcement Decree of the STTCL provides details to measure the scope of full-time employees for the purposes of the tax credit. The eligible employees shall have employment contracts in accordance with the Labor Standard Act. However, the following categories of employees shall not be taken into account: i) a company's representatives or directors including unregistered directors, ii) those in high income brackets of KRW 120 million or more in annual compensation; and iii) employees who are related parties or relatives of the largest shareholder in the company.

Requirements for Companies to Qualify for New Benefits Designed to Facilitate dividend payments

The amended law contains changes to facilitate dividend payments to shareholders of listed companies that lower the withholding rate on dividend income from high-dividend paying listed companies from 14% to 9% and allow the segregated taxation of financial income. The proposed Enforcement Decree of the STTCL includes requirements for listed companies to qualify for benefits under the amended law:

- i) The company's average ratio of dividend to net income for the last three years and the company's dividend yield are both at least 120% of the market average ratio and dividend yield respectively, and the total dividend amount paid increases by 10% or more from the greater of (i) the total dividend amount paid for last year, or (ii) the average dividend amount for the last three years.; or
- ii) The company's average ratio of dividend to net income for the last three years and dividend yield are both at least 50% of the market average ratio and dividend yield respectively, and the total dividend amount paid increases by 30% or more from the greater of (i) the total dividend amount paid

for last year, or (ii) the average dividend amount for the last three years.

Please note the threshold for the market average ratio of dividend to net income and dividend yield is 130% for newly listed companies and listed companies that did not pay dividend in previous years. For these companies, the threshold of total dividend amount paid is not required.

This change will apply to dividends distributed for fiscal years beginning on or after January 1, 2015.

Eligible Scope of Special Tax Reduction for SMEs

The tax law allows a special tax reduction for small and midsize companies (SMEs) at a rate ranging from 5% to 30% depending on the type of industry, corporate scale and region. The amended law extends the type of qualifying industries eligible for the tax reduction to include the movie theater operating industry, the new or renewable energy power generation industry and the residential leasing and management industry.

Special Tax Treatment Control Law

R&D Tax Credit Rate Lowered for Large Corporations

Where large corporations apply the R&D tax credit based upon the current expenses method, the base credit rate is 3% plus any additional credit factor up to a of maximum 1% ($\text{R\&D expenses} / \text{Sales volume} \times 1/2$) resulting in a total available R&D tax credit in the range of 3% to 4%. Under the amendment, the base credit rate is lowered to 2% resulting in the total R&D tax credit rate for large corporations now being in the range of 2% to 3%.

Tax Credit for Income from the Transfer or Leasing of Technology (Korean patent box regime)

Two significant changes are made to the existing tax incentives to support technology transfer which are currently limited to SMEs. One of the changes is to grant a 50% tax credit for income arising from the transfer of technology (including patents) for medium-scale companies as well as SMEs. Requirements for a medium-scale company to qualify for the tax credit will include the annual average sales of KRW 300 billion or less for the previous three years. Another change is to newly grant a 25% tax credit for income derived by SMEs and medium-scale companies from the leasing of patents or

utility model rights where the company has first filed a registration of such rights.

Criteria for Graduation from SME Status

As previously announced, the criteria of SMEs eligible for tax incentives under the STTCL has been amended to be consistent with those specified in the amended regulations of the Basic Act for Small and Medium Enterprises which become effective from January 1, 2015. Under the amended law, the three-year annual average turnover (i.e. KRW 40, 60, 80, 100 and 150 billion depending on the type of industry) serves as the single criterion to determine SME qualification.

The proposed Enforcement Decree includes a change related to the existing four thresholds for the graduation from SME status: the number of full-time employees (1,000), net worth (KRW 100 billion), total assets (KRW 500 billion) and annual turnover (KRW 100 billion). The proposed change will abolish the first two thresholds, but the two other thresholds regarding annual turnover and total assets continue to apply. In addition, a new criterion will also apply to determine the status of medium-scale enterprise, besides the existing threshold of KRW 300 billion in annual turnover. The new criterion requires that a

qualifying medium-scale enterprise must not be a company where: (i) a large corporation having KRW 5 trillion or more in total assets has direct or an indirect ownership of 30% or more of the company; and (ii) a large corporation is also the largest shareholder in the company.

Income Tax Credit for Qualifying Foreign Engineers

Under the existing sunset clause, 50% of wages received by foreign technicians and engineers as specified in the Enforcement Decree are exempt from income tax for two years from the date when they start to render services in Korea. This sunset clause is extended until the end of December 2018 under the amended STTCL. The proposed Enforcement Decree will exclude some foreign workers but extend this income tax credit to research staff working in qualifying R&D centers of foreign-invested companies. The requirements for these R&D centers to be regarded as qualifying for these purposes include: i) they must run their own R&D facilities; and ii) they must have at least five research staff who have a master degree in natural science or who have a bachelor in natural science and have three years of experience in R&D.

Special Tax Treatment Control Law

Tax Credit Rate for Job-Creating Investment

The STTCL has been amended with some modifications from the government's original reform proposal announced last August. The key changes relating to tax credit rates for job-creating investment under the recently amended law include:

- For large corporations, the basic credit is abolished (i.e. from 2~3% to 0%), but the additional credit (which is available in proportion to an increase in job creation) is retained at 3%. For medium-scale companies and SMEs, the basic credit rate is lowered by 1% point to 1~3%, while the additional credit rate is raised by 1% point to 4~5%.
- The additional credit rate is raised by 1% point more for investment in local provinces and service industries as specified in the Enforcement Decree.
- This sunset provision is extended by three additional years until the end of December 2017.
- The service industries eligible for the 1% increase in the additional credit include 37

categories out of 43 industries to which the job-creation tax credit currently applies, excluding agriculture, fishing, mining, manufacturing, gas and construction.

Taxation Method for Gains from the Exercise of Stock options

With respect to the taxation of gains from the exercise of qualifying stock options, currently such gains shall be taxed as payroll income at the time of exercise. Under the amended STTCL, alternatively, such gains can be taxed as capital gains on the subsequent disposal of the stocks acquired from the exercise of the options.

According to the proposed Enforcement Decree, the alternative method will apply on conditions that (i) the stock options should be granted under the Act on Special Measures for the Promotion of Venture Businesses, (ii) the stock option plan should be approved by either a shareholders meeting or board of directors meeting, (iii) the stock options are non-transferrable options, and (iv) the employees should work for 2 years or longer from the stock option grant date. This new rule will apply to qualifying stock options granted on or after January 1, 2015.

Accelerated Depreciation for Service Industry

The amended law allows the accelerated depreciation for companies engaged in the service industry by shortening the standard useful lives by 40% when the amount of investment in fixed assets increases for two consecutive years. The proposed Enforcement Decree includes the following changes as delegated by the amended law:

- The applicable industry will include 37 categories of service industries qualifying for an additional credit for job-creating investment.
- The applicable fixed assets will include facility assets as specified in Article 28 of the Enforcement Decree of the CITL, including (i) machinery and equipment, and (ii) vehicles, vessels and airplanes directly used in transportation or leasing industry.

The change will apply to investments made in a one year period from January 1, 2015 through to December 31, 2015.

Individual Income Tax Law

Tightened Statutory Residency Rule

The statutory residency test rule has been amended to tighten control over potential attempts to avoid the tax liability of a resident. The threshold to test the statutory residency is lowered from one year to 183 days, which is consistent with the criteria adopted in a majority of OECD member countries including the US, UK and Germany. Under the 183-day rule, an individual will be considered a Korean resident for tax purposes if the individual is present in Korea at least 183 days during the current year or during two consecutive tax years.

The proposed Enforcement Decree of the amended Individual Income Tax Law includes certain details to count the 183-day threshold. For example, days of presence in a foreign country for the purposes of vacation or to receive medical treatment for a disease will be counted, but days of presence in Korea for such purposes will not be counted in the 183-day threshold.

Capital Gains Tax on Derivatives

Capital gains tax will apply to income arising from derivative transactions made on or after

January 1, 2016. The proposed Enforcement Decree sets forth details relating to the capital gains tax:

- The affected derivative products must be KOSPI 200 futures and options and derivatives traded on international derivative exchanges.
- The basic tax rate will be 20% but a flexible tax rate of 10% will be applicable as prescribed in the Enforcement Decree.
- Gains from derivative transactions will be separated from other income and will be eligible for a basic deduction (KRW 2.5 million a year).
- Those who earn income from derivative transactions must file a final income tax return and pay tax once a year and are exempt from the requirement to file a preliminary return.
- Financial investment companies must submit transaction details to the relevant tax office by the end of the next month following the end of the quarter when a transaction takes place.



Individual Income Tax Law

Reduction in Retirement Income Deduction

Retirement income is eligible for certain deductions. The amended law replaces a fixed rate deduction (i.e. 40%) with a graded deduction by income brackets in order to give less deduction for high income earners. The deduction rates will range from 35% (for the converted income exceeding KRW 300M) to 100% (for the converted income up to KRW 8M), rather than the earlier proposed 15% ~ 100%, which will result in higher taxable income than the previous method. Accordingly, in order to mitigate an abrupt increase in income tax on retirement income under the new rules, the calculation method seen in the table below shall apply. This change will apply to retirement income earned on or after January 1, 2016.

Year of retirement	Income Tax on Retirement income
2016	80% of the income tax on retirement income calculated under the previous rules + 20% of the income tax retirement income calculated under the amended rules
2017	60% of the income tax retirement income under the previous rules + 40% of the income tax retirement income under the amended rules
2018	40% of the income tax retirement income under the previous rules + 60% of the income tax retirement income under the amended rules
2019	20% of the income tax retirement income under the previous rules + 80% of the income tax retirement income under the amended rules
2020	100% of the income tax retirement income under the amended rules

Director's Retirement Income Eligible for Special Tax Treatment

In order to discourage attempted tax avoidance where any compensation of a director of a corporation is excessively paid in retirement income, a limitation rule was previously introduced effective from 1 January 2012 that meant that for any income paid to a director on his retirement to be eligible for favorable tax treatment, it must not exceed a certain portion of his salary income. Initially, any retirement income accrued before 1 January 2012 was exempt from the application of this rule. Under the tax law amendment, however, a specific implementation rule has been further introduced where the exempt retirement income will be limited in proportion to the ratio of his employment period before 1 January 2012 to his whole employment period.

Tighter Condition for Interim Settlement of Retirement Income for a Director

In order to balance the tax burden between a director and a non-director employee, a condition qualified for interim settlement of retirement income (i.e., payroll system is changed to an annual salary system with no separate severance pay) which has previously been only applied to the director and not to a non-director employee has been abolished. This amendment will be applied to any retirement which takes place effective from January 1, 2016.

VAT Law

Scope of 'Non-traditional' Financial Services subject to VAT

Financial and insurance services are in general exempt from the scope of supplies subject to value added tax (VAT). The VAT law has been amended to include the supply of 'non-traditional' financial services to the scope of taxable supplies. The proposed Enforcement Decree of the VAT law includes five categories of affected non-traditional financial services: (i) safe deposit of securities certificate; (ii) investment advisory; (iii) insurance actuary and pension actuary; (iv) money trust and discretionary investment business investing in real estate and non-financial assets; and (v) real estate trust business limited to management, disposition and parcel-out administration.

This change will apply the supply contracts made on or after July 1, 2015.

VAT on B2C Digital Service Sales on Offshore Open Markets

The VAT law has been amended to apply VAT to business-to-customer supplies of electronic services (applications, MP3, music, films, etc.) purchased through offshore open markets app

stores. If an app developer is a foreigner, the amended law requires offshore open marketers to undertake procedures online including a simplified VAT registration process and a VAT return filing and payment process through the homepage of the National Tax Service. The proposed Enforcement Decree of the amended VAT law includes details on the affected services, registration and payment procedures and tax invoices:

- The affected digital services include: streaming service, program update, remote service provision (news, traffic information, etc.), software, electronic documents, etc.;
- Examples of the requirement information for the online registration include the name of the company and representative, contact information, the jurisdiction where the marketer's business is registered, service type and the launch date of the domestic service.
- VAT payment will be made through a foreign exchange bank account either in a foreign currency or Korean Won.
- These service providers, however, will be exempt from the requirements for issuing VAT invoices.

This change will apply to the supply of services on or after July 1, 2015.

Zero-rating VAT to the supply of Clinical Services to Foreign Companies

When a domestic hospital or medical institution supplies clinical trial services to a foreign pharmaceutical company outside Korea and receives consideration for the supply of services in a foreign currency, zero-rating VAT will apply to the supply of these services. This rule will be immediately effective after the amended rules is proclaimed.

Input VAT Credit for the cost of Vehicles used for Unmanned Security Service

Input VAT paid on the purchase or maintenance of vehicles to be used for unmanned security services will be refundable, effective from the date the new rule is proclaimed. Currently, such input tax credit is limited to vehicles purchased for the purpose of sale, transportation or rental business.

Law for Coordination of International Tax Affairs

Harmonization of Transfer Pricing and Customs

Currently, taxpayers subject to transfer pricing adjustments for corporation tax purposes or adjustments to transaction values for customs duties purposes may request reviews to obtain “advanced corresponding adjustments.” The proposed Enforcement Decrees of the Law for Coordination of International Tax Affairs (LCITA) and the Customs Act include details related to the advanced corresponding adjustments:

- The review will be available when the methods employed for transfer pricing purposes and customs valuation purposes are similar. In other words, it will be available when one of the following methods is adopted to determine the arm’s length price or customs value: the comparable uncontrolled price method, the resale-price method and the cost plus method as prescribed in Article 5, Paragraph 1 of the LCITA and the transaction price of goods of the same kind and quality method, the transaction price of similar goods method, the domestic sale price back calculation method and the

calculated price method as prescribed in Articles 31~34 of the Customs Act.

- The relevant authorities must notify a taxpayer filing a request for an advance corresponding adjustment of their review results within 90 days from the date the application is accepted. If the application is rejected, the taxpayer must inform the relevant authorities of whether the taxpayer intends to separately seek an advance pricing agreement (APA) for corporation tax or an advance customs valuation agreement (ACVA) for customs within 30 days from the date the notification is received.
- The methods and procedures for reviewing and recognizing the advance corresponding adjustment will be similar to those adopted for APA and ACVA purposes.

This change will be applicable to requests filed on or after the date the amended rules are proclaimed.

Temporary Exemption from Penalty of Voluntary Self-disclosure of Offshore Income

The amended LCITA introduces a voluntary program for self-disclosure of income earned offshore. This will allow Korean residents and domestic companies to voluntarily disclose their offshore income to the Korean tax authorities and reduce or exempt certain penalties for the non-compliance. However, an interest charge will be imposed on inaccurate or untimely compliance. Disclosure of personal information to the public could also be waived under the voluntary self-disclosure program. This new rule will temporarily apply to income earned or properties held offshore which must be filed with the government authorities under tax laws. However, it will not apply to those who are subject to ongoing tax audits or investigations. This change will be implemented for an interim period until the end of December 2016.

Customs Duty Act

Changes in Customs duty-related Penalties

Reduction in Penalty for Inaccurate

Filing of Customs Duty: When taxpayers correct an inaccurate customs duty return and file an amended return voluntarily within six months after the due date, currently there is no penalty for the under-reported amount. However, when the amended return is filed after six months, there is no reduction in the penalty. The amended law introduces a reduction in penalties in this case. The penalty will be reduced by 20% if the amended return is filed after six months, but within one year from the original due date and by 10% within the period ranging from one year to two years from the original due date.

Increase in Penalty rate for unpaid

customs duty: The interest rate applicable to the unpaid amount of customs duties shall be 0.03% per day (10.95% p.a.), an increase from the current 0.013% per day. This is to apply the penalty rates on unpaid national taxes and customs duties in a consistent manner.



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