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Korean Tax Brief

Update on Current Issues and Trends

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Tax law amendments and announcement of proposed amendments to Enforcement Decree

On December 2, 2016, the Korean National Assembly passed the proposed tax law amendments for 2017. The Ministry of Strategy and Finance subsequently announced the 2016 proposed amendments to the Enforcement Decree of tax laws on December 27, 2017 in order to set forth details delegated by the amended tax laws. Once approved by the president's state council, the amendments to the Enforcement Decree will become effective from February 3, 2017. Below are some highlights in the tax law amendments enacted by the National Assembly.

(1) Extension of the sunset period for flat tax rate for foreign workers and raise of the flat tax rate (Tax Incentive Limitation Act §18-2)

The existing sunset provision, which expired on December 31, 2016, allowed foreign workers to apply the flat tax rate of 17% to their employment income earned up to first five years of employment in Korea. The amended law extends the sunset period to the end of 2018 thereby allowing foreign workers who started working in Korea on or before December 31, 2018 to elect the flat tax rate for five years. Under the existing provision, the foreign workers who started working in Korea before January 1, 2014 were not subject to the 5-year limitation. However, under the new rule, they will be able to apply the flat tax rate until December 31, 2018 and no longer. Also, the flat tax rate will be increased to 19% in order to narrow the gap between the flat tax rate and the progressive tax rate, which is applicable to Korean nationals. The new rule is effective from January 1, 2017.

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(2) Annual limitation on the use of carried forward tax loss for foreign companies (Corporate Tax Act §91 (1))

Under the tax law amended as of December 15, 2015, domestic companies' use of carried forward tax loss has been limited to 80% of the taxable income on an annual basis. However, foreign companies remained unaffected by this rule. In order to improve fair and equal taxation between domestic and foreign companies, the amendment sets the equal limit of 80% of the business year's taxable income on the foreign companies' use of the carried forward tax loss. This rule is applicable to fiscal year starting on or after January 1, 2017.

(3) Changes to the excess retained earnings taxation (Corporate Tax Act §56, Enforcement Decree of the Corporate Tax Act §93)

Under the existing tax law, corporations with shareholders' equity exceeding KRW 50 billion or corporations belonging to an enterprise group subject to limitations on mutual investment are taxed on the excess retained earnings that are not paid out as investment (acquisition of tangible assets for business purposes, etc.), salaries, or dividends. Companies subject to the excess retained earnings taxation can select the taxation method between (a) [current year income×80% - (investment + wage increase + dividend payout, etc.)]×10%; or (b) [current year income×30% - (wage increase + dividend payout, etc.)]×10%. Once a method has been elected, it must be applied for at least three consecutive years.

The amendment allows companies to switch the method from (b) to (a) and expands the scope of qualified investment to include new venture capital investments. It also gives weight to wage increase against dividend payout by multiplying the wage increase by 1.5, whereas multiplying the dividend payout by 0.5. The new rule is effective from fiscal year starting on or after January 1, 2017.

(4) Tax benefits for foreign investments in new prospective industries (Restriction of Tax Incentive Limitation Act §121-2, Enforcement Decree of the Tax Incentive Limitation Act §116-2)

Under the existing tax law, reduction or exemption from corporate tax, income tax, acquisition tax, and property tax may be granted to foreign direct investments in businesses accompanying high-tech or industry-supporting service businesses. In case that tax incentives are granted, tax benefit applies only to tax on the portion of income derived from the businesses eligible for tax incentives within the limit of 90% of foreign investment amount.

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In order to encourage foreign investments in new prospective industries, the amendment restructures business types eligible for the tax incentives by selecting 11 new prospective industries as future growth engines. Also, under the new rule, the whole income may be exempt from taxation if the ratio of income derived from the business eligible for tax benefits is 80% or more. Furthermore, the ceiling of tax benefits will be raised to 100% of foreign investment amount. The new rule took into effect from January 1, 2017.

(5) Tax deferral allowed for merger between sister companies (Corporate Tax Act §44(3))

According to the Corporate Tax Act, in case that a domestic company merges with or is merged into its wholly owned subsidiary, gain or loss from the merger may be deemed nil regardless of the requirements of a qualified merger. Under the amendment, if the merger is between companies wholly owned by the same parent company (i.e., sister companies), it may be also deemed as a qualified merger, thus tax deferral may be allowed despite the qualified merger requirements. The new rule became effective from January 1, 2017.

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