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Korean Tax Brief

Update on Current Issues and Trends

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1. Employment-related Tax Systems are Strengthened

As employment slowdown continues, the government strengthened the taxation systems related to employment, such as job creation tax credit, tax system for increasing youth employment, etc. to support corporate job creation. The relevant revision bill of the Restriction of Special Taxation Act ("RSTA") was promulgated on April 18, 2017.

The major revisions are as follows.

Increase in additional tax credit rate for job creation tax credit

The job creation tax credit is calculated by multiplying the capital expenditure by the additional tax credit rate, but the amount creditable is limited to the amount multiplied by KRW 15 million to KRW 25 million (KRW 10 million to KRW 20 million for large and medium-sized companies) per employee newly hired. Under the revision bill, the additional tax credit rate temporarily increased by 2%p (4% to 6% → 6% to 8%) for small companies and 1%p (4% to 6% → 5% to 7 %) for medium-sized companies by the end of 2017. For large companies, the current tax credit rate is maintained at 3% to 5%.

Expansion of tax credits on increasing youth employment

Tax credits on individual income tax and corporate income tax are available for the companies if the number of full-time youth employees increases compared to the immediately preceding fiscal year. Under the revision bill, available tax credits increased from KRW 5 million to KRW 10 million per full-time youth employee newly hired for small companies, from KRW 5 million to KRW 7 million for medium-sized companies, and from KRW 2 million to KRW 3 million for large companies.

Expansion of tax credits on conversion from temporary position into full-time employee

As of June 30, 2016, companies may receive tax credits on individual income tax and corporate income tax when temporary employees are converted into permanent positions by the end of 2017. Under the revision bill, available tax credits increased from KRW 2 million to KRW 7 million per employee for small companies and the credit of KRW 5 million per employee is also available for medium-sized companies.

2. Revision Bill of Act on External Audit of Corporations is Pending

The amendment made to the Commercial Law in 2012 lifted restrictions on total number of employees and transfer of shares by members (investors) of the limited company and enabled limited companies to operate its business like a stock company. Many global companies entering the country are currently operated in a form of a limited company since limited companies are not subject to an external audit, there is no obligation to disclose corporate financial information, and a relatively advantageous accounting system applies. However, these companies do not disclose financial accounting information to stakeholders, such as creditors and business partners, taking advantage of the fact that they are not subject to an external audit, resulting in an issue that it is unable to confirm how much these companies earn and where the income is used. Recognizing such issues, there have been calls to take measures to block tax evasion that may occur from transferring the income earned in the Korean market to overseas headquarters in the name of dividend, management fee, brand royalty, etc.

In order to improve transparency in such limited companies, the government has proposed the “revision bill of Act on External Audit of Corporations (“revision bill of AEAC”)” including limited companies to be subject to an external audit. However, the proposed revision bill of AEAC is currently pending in the National Assembly (National Policy Committee) due to the recent political issues. It is uncertain at the moment whether or not the revision bill of AEAC will be passed.

Inside and outside of the accounting industry, there are rising concerns on the fact that accounting practices in the limited companies are not properly managed and overseen in awareness of the necessity for ‘transparency of accounting’. There are also arguments that the revision bill of AEAC currently pending in the National Assembly must be tightened and that external audit and disclosure for limited companies is essential for prevention of “Base Erosion and Profit Shifting (BEPS)”.

3. A person who is obligated to submit payment statements under Article 120-2(1) of the former Corporate Income Tax Act refers to the withholding agent of the income prescribed in Article 98, and if a foreign corporation does not apply an exemption application, it is not exempt from the obligation to submit payment statements, even if a domestic-sourced income is exempt from corporate income tax (Supreme Court 2016. 12. 1. Declared 2014Doo8650 sentenced)

A person who has the obligation to submit payment statements based on Article 120-2(1) of the former Corporate Income Tax Act ("CITA") on a domestic-sourced income of foreign corporations specified in Article 93 of the former CITA refers to the withholding agent of the income prescribed in Article 98 based on the facts that i) submission of payment statements is an cooperative obligation to identify source of income and to improve the objectivity of transaction by submitting statements including amount of income and income owner, etc. to the competent tax office, thus it is reasonable for the withholding agent to bear such obligation and ii) under Article 120 of the former CITA, the withholding agent is obligated to submit payment statements in case of a domestic corporation. Meanwhile, if a foreign corporation does not apply a non-taxation or exemption application to the competent tax office for tax payment, even if a domestic-sourced income is non-taxable or exempt from corporate tax under the tax treaty, it is reasonable that the withholding agent is not exempt from the submission of payment statements.

4. If a holding company established or converted under the Fair Trade Act incorporates a subsidiary by acquiring shares of a domestic company at once and becomes a majority shareholder of the domestic company, it is exempt from a deemed acquisition tax (Supreme Court 2017. 4. 13. Declared 2016Doo59713 sentenced)

The legislative intent of Article 120(6)-8 of the former Restriction of Special Taxation Act which exempts a holding company from the deemed acquisition tax is to support corporate restructuring for rationalization of ownership and management by providing tax benefits for establishment of or conversion to a holding company. Considering the purpose of tax benefits for the holding companies and types of incorporation of a subsidiary by holding companies permitted by the Fair Trade Act ("FTA"), along with the tax exemption provision, if a holding company established or converted under the FTA incorporates a subsidiary by acquiring shares of a domestic company that is not an affiliated company at once and becomes a majority shareholder of the domestic company, it is exempt from a deemed acquisition tax.

5. When calculating 'the income generated from business subject to tax exemption' for the corporate tax exemption on foreign investments, an objective and reasonable method considering the nature of the business can be used (Supreme Court 2017. 4. 13. Declared 2016Doo64043 sentenced)

If the income from a business subject to tax exemption ("tax-exempt business") comprises a portion of the company's overall income along with other taxable business, the income attributable to the tax-exempt business should be classified from the total income. However, the former Restriction of Special Taxation Act does not specify the method concerning income classification and calculation of income for each business when a product produced from the tax-exempt business is used for the production of other non-tax exempt business. In such a case, 'the income generated from the tax-exempt business' can be calculated by an objective and rational method, such as a cost method based on a total sales of the business, taking the nature of the business into consideration.

KPMG contacts

For more information about how KPMG Tax can help your business with tax matters, please contact one of the following professionals.

Head of Tax

Choi, Jeong Wook
T. 82(2)2112-0990
E. jeongwookchoi@kr.kpmg.com

Global Tax Services

Ihn, Byung Choon
T. 82(2)2112-0983
E. bihn@kr.kpmg.com

Domestic Tax Services

Lee, Kwan Bum
T. 82(2)2112-0917
E. kwanbumlee@kr.kpmg.com

Lee, Chan Gi
T. 82(2)2112-0913
E. changilee@kr.kpmg.com

Financial Tax Services

Cook, Chang Soo
T. 82(2)2112-0918
E. changsoocook@kr.kpmg.com

kpmg.com/kr

Accounting and Tax Outsourcing(ATO) & Global Mobility Services

Kim, Kyeong Mi
T. 82(2)2112-0919
E. kyeongmikim@kr.kpmg.com

Transfer Pricing

Kang, Gil Won
T. 82(2)2112-0907
E. gilwonkang@kr.kpmg.com

M&A Tax Services

Oh, Sang Bum
T. 82(2)2112-0721
E. sangbumoh@kr.kpmg.com