Executive summary

On 2 December 2015, Korea’s National Assembly passed the 2016 tax reform bill (2016 tax reform). The 2016 tax reform is aimed at stimulating the domestic economy, strengthening fair taxation and rationalizing the tax system; it was enacted on 15 December 2015. Enforcement Decrees, which provide more specific guidance to the laws, are soon to be approved by the President. This Alert summarizes key features of the new and amended tax laws.

Detailed discussion

Limitation on utilization of net operating losses

Under the current tax law, net operating losses (NOLs) can be carried forward for 10 years to offset taxable income without any limitation. The 2016 tax reform sets a per year deductibility limitation at 80% of taxable income but small and medium sized companies and certain companies specified under the Enforcement Decree of Corporate Income Tax Law (CITL ED) which include companies under court receivership, will not be subject to the 80% limitation. The amended law will be effective for fiscal years beginning on or after 1 January 2016.
Reduced tax credit for investment in certain facilities

The sunset clause granting tax credits for investments in research and development (R&D) facilities is extended for another three years, but the applicable tax credit rates for the extended years will be reduced. The sunset clause for tax credits for investments in energy saving facilities will not be affected, but the applicable tax credits will be reduced for the investment made in 2016.

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<tr>
<th>Tax credits</th>
<th>Current</th>
<th>Amended</th>
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<tr>
<td>R&amp;D facilities</td>
<td>- Large corporations: 3%</td>
<td>- Large corporations: 1%</td>
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<td></td>
<td>- Medium-sized corporations: 5%</td>
<td>- Medium-sized corporations: 3%</td>
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<td></td>
<td>- Small-sized corporations: 10%</td>
<td>- Small-sized corporations: 6%</td>
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<td></td>
<td>- Until 31 December 2015</td>
<td>- Until 31 December 2018</td>
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<tr>
<td>Energy saving facilities</td>
<td>- Large corporations: 3%</td>
<td>- Large corporations: 1%</td>
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<td>- Medium-sized corporations: 5%</td>
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Additional documentation requirement relating to international transactions

Amendment of the tax law imposes a new documentation requirement for certain multinational companies to submit information on international transactions, which is in line with the Organisation for Economic Co-operation and Development's Guidance on Transfer Pricing Documentation and Country-by-Country Reporting as a part of the Base Erosion and Profit Shifting project. The new obligation will apply to domestic corporations that have transactions and assets exceeding specific thresholds and foreign corporations having a permanent establishment in Korea.³ The multinational companies to which the new obligation applies should submit to the Korean tax authority a comprehensive international transaction report containing management information on those companies and information on transfer pricing with foreign related parties, which is in line with the Master File and Local File requirements, by the corporate tax return filing due date.⁴ Failure to comply with the reporting requirement will result in a noncompliance penalty of KRW10 million (approximately US$8,500). The amended law will be effective for fiscal years beginning on or after 1 January 2016. This means that the first report must be submitted by the corporate tax return due date for the taxable year beginning on or after 1 January 2016.

Revised criteria for determining real property holding company status for capital gains tax purposes

Under the current tax laws, if a nonresident person or a nonresident corporation disposes shares in a Korean real property holding company (RPHC) whose majority assets (50% or more) comprises of real property, it is deemed to have disposed the underlying real property, subject to capital gains tax unless exempt under the applicable tax treaty. Under the 2016 tax reform, a Korean company would be viewed as an RPHC if the sum of the following is 50% or more of the company's total assets:

i) Value of real property held by the company, and

ii) Value of the company's shareholding in “another RPHC” multiplied by the percentage of real property over the total assets of “another RPHC.”

The amended law will apply to a share transfer made on or after 1 January 2016.
Narrowed scope of electronic services subject to VAT registration

Under the current Value-Added Tax (VAT) law, nonresidents providing electronic services (e.g., games, sounds, video files, or software) in Korea must register for VAT purposes using a simplified online VAT registration method and pay the 10% VAT on its supply of electronic services from 1 July 2015 (new VAT regime on electronic services). Under the amended tax law, the new VAT regime on electronic services will not apply if the electronic services are rendered to a domestic entrepreneur, which is registered for VAT purposes in Korea (i.e., business to business transactions). The amended VAT law will become effective from a taxable period during which the amendment is enacted. Accordingly, if the revision is enacted by the end of 2015, the new VAT regime on electronic services for the taxable period covering July to December 2015 and thereafter will be applicable only to business to consumer transactions.

Reciprocal application of zero-rated VAT for certain services

According to the 2015 Proposal, the zero-rated VAT applicable to certain services rendered to a nonresident person such as professional services (i.e., legal, accounting, tax, advertising, market survey and management consulting services) and business support services (i.e., manpower supply, employment delivery, and other business supporting services) will apply only in the case that a country where a counterparty is a resident applies the same zero-rated VAT or exemption on such services (i.e., on a reciprocal basis). The revised rule will apply to the supply of such services on or after 1 July 2016. This is a proposed amendment to the VAT law Enforcement Decree, and is still pending, subject to a presidential approval.

Endnotes

2. Under the Small and Medium Sized Company Act, if a company meets certain conditions (including the ceiling of revenue per industry), it is considered a small and medium sized company.
3. The criteria will be outlined in an Enforcement Decree under the Law for the Coordination of International Tax Affairs.
4. Three months after the fiscal year ends.
5. The definition and computation methodology of real property ownership of “another RPHC” will be defined through the amended CITL ED to be approved early 2016.
6. See EY Global Tax Alert, South Korea applies VAT on electronic services provided by foreign service providers, dated 11 August 2015.
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