GMS Flash Alert

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South Korea - Changes in Income Tax Rates, Tax Residency Conditions, and More

South Korea's National Assembly approved the 2018 Tax Law Amendment Bill early this year.[1] The Bill (hereinafter, "revised law") had been announced by the government on 2 August 2017.[2]

In this GMS *Flash Alert*, we provide a summary of the key features of the revised law that could impact international executives and their multinational employers, including changes to:

- marginal income tax rates,
- employer's obligations to file a payroll withholding tax return at a new flat rate on the service fee payable to a foreign entity dispatching its employees, and
- the threshold above which individuals are required to file a Report of Foreign Bank and Financial Accounts ("FBAR") by 30 June.

WHY THIS MATTERS

Notwithstanding the loosening of the criteria for tax residency, tax costs and budgeting for assignments to and from South Korea could be affected by the modification in income tax rates (which we discuss further below). Employers may need to make the necessary payroll adjustments and update hypothetical taxes for tax equalized assignees.

Loosened Tax Residency Condition

Under domestic income tax law, one of the criteria for tax residency was having a domicile in South Korea for 183 days or more that started from two years before the end of the relevant year. However, effective from 1 January 2018, this rule is loosened to 183 days or more in one tax year. The aim is to encourage more investment in the country.

New Top Marginal Income Tax Rates

Effective from 1 January 2018, the new top marginal income tax rate of 42 percent (46.2 percent including local income tax) is to be applied to taxpayers with an income tax base in excess of KRW 500 million.

The second top income tax rate of 40 percent (44 percent including local income tax) is to be applied to tax bases in excess of KRW 300 million and up to KRW 500 million. This step is intended to improve income redistribution in the country by imposing higher taxation on those with higher incomes.

Until 2017, the highest marginal income tax rate was 40 percent (44 percent including local income tax) which was applicable to tax bases in excess of KRW 500 million. The second highest marginal income tax rate was 38 percent (41.8 percent including local income tax) which was applicable to tax bases in excess of KRW 150 million and up to KRW 500 million. (For prior coverage of changes to the rates, see GMS *Flash Alert* 2017-006, 12 January 2017.)

KPMG NOTE

- Of interest to high-income earning international assignees, a foreign worker who starts to work in South Korea before 31 December 2018, can elect to have the flat tax rate of 20.9 percent (inclusive of local income tax) applied for five consecutive tax years, including the first year he/she starts to work in the country.

- Foreign workers who had been "continuously" working as of 1 January 2014, will be able to apply a flat tax rate until 31 December 2018. The tax costs for those who are not eligible for the flat tax rate will be affected by the changes in the top marginal income tax rate.

Increased Withholding Tax Rate for Employees Dispatched from a Foreign Entity and Extended Conditions on Korean Companies

Under certain conditions, a South Korean company is required to file a payroll withholding tax return at a flat rate of 17 percent (18.7 percent including local income tax) on the service fee payable to a foreign entity dispatching its employees. (For prior coverage, see GMS *Flash Alert* 2016-057, 6 May 2016.) However, with the new legislation, the withholding tax rate is to be increased to 19 percent (20.9 percent including local income tax) effective from 1 July 2018.

In addition, the conditions that apply to South Korean companies that must comply with the rules are being extended since the government wishes to exercise greater fiscal control over expatriates subject to tax in the country. The conditions are:

1) The annual service fee payable to the foreign entity exceeds KRW 2 billion (KRW 3 billion until 30 June 2018).

2) The business of the South Korean entity falls under one of the following "mandatory" industries: aviation transportation, construction, professional, scientific or engineering services and the following newly-covered industries effective from 1 July 2018, ship-building and financial services.

3) Prior year's gross sales of the South Korean entity are KRW 150 billion or more, or the prior year's total assets are KRW 500 billion or more.

KPMG NOTE

- The assignee-related withholding obligation is applicable to domestic corporations. A South Korean branch of a foreign headquarters is therefore exempt from this rule.

- The assignee-related withholding tax rate is increased in conformity with the previous amendment to the flat tax rate effective from 1 January 2017. Ship-building and financial services are newly added to the categories of businesses falling under this rule.

Toughened Requirement for Reporting Foreign Bank and Financial Accounts (FBAR)

Effective from 1 January 2018, tax residents in South Korea that have financial accounts opened with foreign financial institutions are required to file a Report of Foreign Bank and Financial Accounts (FBAR) by 30 June if the aggregate balance in those foreign financial accounts (securities, derivatives, or other financial instruments) exceeds KRW 500 million (it used to be KRW 1 billion until 2017) on the last day of the month of the year.

KPMG NOTE

- A foreign resident who has/had his/her domicile or place of residence in the Republic of Korea for not more than five years in total starting from 10 years prior to the end of the relevant year is exempt from South Korean FBAR reporting.

FOOTNOTES:

1 To see "Main Contents of the Revised Tax Act to Be Enforced in 2018, and Key Areas of Deliberation," (in English), click here.

2 For prior coverage see the following issues of GMS *Flash Alert*: 2017-133 (6 September 2017) and 2017-006 (12 January 2017).

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[KRW 1 = GBP 0.000672 | KRW 1 = USD 0.0009245 | KRW 1 = EUR 0.0007566 | KRW 1 = AUD 0.0019]

Contact us

For additional information or assistance, please contact your local GMS or People Services professional or the following professional with the KPMG International member firm in South Korea:

So-Hyeon Jung
Director/GMS
Tel. + 82 (2) 2112 7657
sohyeonjung@kr.kpmg.com

The information contained in this newsletter was submitted by the KPMG International member firm in South Korea.

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