

☞ The following tax information is translated from Korean for foreign-invested companies, and is not legally binding.

(Continued from last month) Major revisions to this year's tax laws II

※ Introduction of limitations on tax deductibility of multinational companies' interest expenses (Article 15-2 of the Adjustment of International Taxes Act, newly inserted)

Overview

- Applied to: Domestic companies (including the domestic place of business of a foreign company) having transactions with an overseas special related party
  - Finance and insurance companies are excluded.
- Limitation of deductibility: If net interest expense accounts for a certain percentage (30%) of tax-adjusted income, the excess interest expense shall not be recognized as deductible expense.
  - Calculation of adjusted income: Depreciation expense on fixed assets and net interest expense are added to the income of each business year.
  - Interest expense applied: Net interest expense for overseas special related parties (Interest payment-interest received)
- Between the thin capitalization system and the limitation of deductibility of interest expense, the regulation that produces the larger amount of non-deductible expense shall apply.

(Reason for revision) To prevent multinational companies' tax evasion through excessive deduction of interest expense.

(Applicable period) Starting from the business year commencing on or after Jan. 1, 2019.

Background of introduction

- The OECD recommended introducing regulations limiting the interest expense/earnings ratio to a set percentage, in order to prevent multinational companies' tax evasion through excessive interest expense deduction (OECD BEPS Project Action 4).
  - Korea has been operating the thin capitalization rule since 1997, but the current rule only applies to borrowings from overseas controlling shareholders and therefore does not apply to borrowings from overseas subsidiaries. Also, the rule does not directly restrict the ratio of interest expenses to earnings.
  - In this regard, in line with the OECD recommendations, regulations limiting the interest expense/earnings ratio was introduced for overseas special related parties including overseas subsidiaries.
    - However, considering that Action 4 is a common approach (i.e., a recommendation) and is in the early phase of introduction, the revision was made as simple as possible to reduce the burden on companies.
  - The existing thin capitalization rule and the new limit on interest expense/earnings ratio shall both be applied, and the regulation that produces the larger amount of non-deductible expense shall be applied.
- \* Japan, France and the U.S. also operate both regulations.

※ Increase in dispatched workers' withholding tax rate and expansion of scope of withholding agents (Article 156-7 (1) of the Income Tax Act, Article 207-10 (1) of the Enforcement Decree of the Act)

In order to tighten control on the tax source from foreign dispatched workers, the following revisions will be made:

- Expansion of scope of withholding agents:
  - Current: A domestic company whose total payment in return for labor provided paid to a foreign company exceeds 3 billion won per year
  - Revised: A domestic company whose total payment in return for labor provided paid to a foreign company exceeds 2 billion won per year
- Expansion of scope of businesses subject to withholding
  - Current: Air transportation, construction and professional, science and technology services
  - Revised: Vessel construction and finance businesses added to the list
- Increase in withholding rate: 17% (current) → 19% (revised)

(Reason for revision) To strengthen management of tax source from foreign employees dispatched to Korea

(Application) Applied to payment for labor provided paid on or after Jul. 1, 2018

☞ For more information, please contact the International Tax Resource Management Office of the National Tax Service (82-44-204-2872~74).