South Korea: New rules proposed for applying the flat income tax rate to foreign workers

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In brief

On August 8, 2013, the Ministry of Strategy and Finance (MOSF) announced South Korea's tax reform package for 2013. The MOSF proposals include two changes with respect to the application of a flat tax rate on employment income of foreigners working in Korea. These changes could potentially eliminate the favorable benefits of the flat tax rate if an assignee falls within their parameters.

The proposed reforms infer in what direction tax policies may proceed over the next five years and thus taxpayers should consider how they may affect their business. The reforms aim to support the government's fiscal tasks, promote fairness in taxation, and expand the sources of tax revenue.

In detail

Flat tax rate application waived for certain employees

Foreign expatriates or employees working in Korea can choose the application of either a flat income tax rate (currently 17% excluding resident surtax) or normal progressive tax rates (currently ranging from 6% to 38% excluding resident surtax), whichever is more beneficial to them. If the flat tax rate is applied, however, neither non-taxable treatment nor income deductions/credits are available.

Currently, the flat income tax rate is available for all foreign expatriates and employees in Korea. However, the proposal contains a new rule that would waive (i.e., eliminate) the application of the flat tax rate for any foreign worker who is a related party to his/her employer in terms of governance or close relative relationships (relationship of management control, family/relative relationship).

Five-year time limit for foreign workers

Currently, the income tax law has no provision that limits the time for which the flat tax rate is applicable. Under the proposal, a new provision is proposed to set the time limit of the applicable period at five years from the date the Korean assignment of a foreign worker starts.

Details on how to count the five-year time limit and what interim measures to be taken for foreign workers who have worked in Korea for longer than five years before the enforcement of the proposed new rule, and other pending issues will be set forth in the Enforcement Decree of the concerned tax law.

Effective date

If the National Assembly of South Korea passes the tax reform bills that has been proposed by the MOSF, the proposed changes with respect to the application of a flat tax rate will become effective for employment income incurred on and after January 1, 2014.

The takeaway

Companies with assignees working in South Korea should review these populations and whether they have been reaping any benefits from the flat tax rate regime. If yes, they should consider the effect these two provisions may have on mobility costs. Does the company anticipate assignments that may exceed this five-year timeframe? Are there situations where assignees are related to persons in charge of governance for that company?

Let's talk

For a deeper discussion of how this issue may affect you, please contact:

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