Lee & Ko

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Newsletter | Tax Group

Recent Decision by the Tax Tribunal Regarding Application of the Flat Tax Rate to Foreign Employees

Application of the flat tax rate to "a foreign employee who worked in Korea for a period which ended before January 1, 2014, and recommenced working in Korea after January 1, 2014"

Lee & Ko recently obtained a favorable decision from the Tax Tribunal regarding a foreign employee who: (1) worked in Korea for a period of time which ended prior to January 1, 2014; and then (2) returned to Korea and started working in Korea again after January 1, 2014.

◈ Facts

The facts in this appeal involved a foreign employee working in Korea between 2006 and 2007, and thereafter left Korea to work in a foreign country. After 2015, the foreign employee returned to Korea and started working in Korea again. During the years 2015 through 2017, the foreign employee filed income tax returns by applying the flat tax rate to his income.

◈ Relevant Tax Law

According to Article 18(2) of the Tax Preference Control Act ("TPCA"), a foreign employee is allowed to apply the flat tax rate to income from his or her labor for 5 years from the date the person first begins employment in Korea.

◈ NTS' Challenge and Tax Assessment

The National Tax Service ("NTS") interpreted the meaning of 'the date the person first provides labor in Korea' literally and refused to apply the flat tax rate to the foreign employee who began to provide labor after January 1, 2014, because the foreign

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employee also provided labor in Korea before January 1, 2014. The NTS argued that in such case the five year period would have already expired, since the clock would start to run from the date the employee first began to provide labor in Korea, before January 1, 2014.

The NTS took the position that the flat tax rate is applicable only for the first five consecutive years from the date the person first began to provide labor in Korea (in this case, from FY 2006). Therefore, the NTS determined that the foreign employee was not eligible to apply the flat tax rate to his income for the 2015 to 2017 period. Consequently, additional income tax (in the form of applying the general progressive tax rates) was imposed as well as a penalty.

◈ Lee & Ko's Arguments

Lee & Ko argued that even in such a case the foreign employee should be entitled to the flat tax rate for five years from the date the employee begins to work again in Korea after January 1, 2014. Lee&Ko argued that the NTS interpreted the TPCA in such a way that they were retroactively applying the amended tax law to the period before the amendment. Thus, the NTS were violating the general principle prohibiting retroactive imposition of tax law. Lee & Ko also pointed out that such an interpretation of the law violated the general principle of fair taxation by causing unequal tax treatment among foreign employees, and also contravened the purpose of the law, which aims to provide special tax treatment for foreign employees.

◈ Decision of the Tax Tribunal

The Tax Tribunal held that the flat tax rate applies to foreign employees in Korea for a period of five years, starting from the first date that they begin to provide labor in Korea after January 1, 2014 regardless of whether such foreign employee was previously employed in Korea in a period earlier than January 1, 2014.

◈ Observation

Lee & Ko successfully persuaded the Tax Tribunal to agree with all of its arguments, and to cancel the additional taxes imposed on the taxpayer in full. In this regard, other foreign employees in similar circumstances are expected to be eligible for the cancellation of additional tax soon.

Foreign employees who were not able to apply the flat tax rate in the past due to the NTS interpretation can now claim refunds by filing amended income tax returns for the past five years.

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