



Samil Commentary

Korean Tax Update

September 18, 2009

This publication contains information on selected current developments in Korean taxation, laws and regulations compiled by the tax service group of Samil PricewaterhouseCoopers, a network firm of PricewaterhouseCoopers.

Tax Reform Proposals for 2010 (2)

The September issue of our Tax News Flash contained major elements of the tax reform proposals announced by the Ministry of Strategy and Finance at the end of August that include: tax incentives to support research & development and green energy investment; and proposals to stimulate corporate restructuring and to reduce tax benefits for large corporations.

This month issue of Samil Commentary highlights additionally selected tax reform proposals for 2010 as provided below. If passed by the National Assembly in December, most of the proposed changes would be effective on January 1, 2010 unless specified otherwise.

Tax Reform Proposals (2) Rulings

- Tax Credit for Research and Manpower Development Expenses
- Recapture of Exempted Taxes in In-kind Contributions
- VAT Exemption for Re-imports within a Certain Period
- VAT Base
- Existing Tax Incentives for Changed Entity Type

Easing of Indirect Foreign Tax Credit Requirements

The tax law allows a domestic corporation to obtain an indirect foreign tax credit of the underlying foreign taxes on dividends paid by its overseas subsidiary as long as the domestic corporation holds 20% or more of shares in the subsidiary. The 20% threshold would be lowered to 10% to facilitate inbound remittance of funds from overseas subsidiaries to domestic companies.

New Tax Incentive on Issuance of Islamic Sukuk Bonds

Interest arising on foreign currency-denominated bonds issued by domestic companies is currently exempt from withholding tax in Korea. This tax incentive would be extended to the proceeds from the issuance of foreign-currency denominated Islamic sukuk bonds to entice Islamic investment in the Korean capital market. In this context, corporate income tax, value added tax and other relevant tax would be exempt for the acquisition of assets through the issuance of Islamic sukuk bonds. The proposed new incentive may be applicable to Ijara or Murabaha Sukuk bonds to be issued by overseas special purpose companies established by domestic companies because Korea's existing financial laws provide no framework for domestic companies to directly issue Islamic bonds.

Income Taxation on Foreigners

Currently, foreign expatriates or employees working in Korea are benefiting 30% deduction of their salaries in calculating the income tax base. Alternatively, foreign expatriates or employees can choose to apply a flat income tax rate of 16.5% (including resident surtax) on their salary income earned in Korea. Under the latest proposal, the 30% non-taxable income alternative would be abolished, while the uniform flat income tax rate would be retained.

In addition, the current five-year salary income tax exemption for qualifying foreign engineers would be reduced to two years with a lower rate of 50% exemption than the current 100%. This sunset clause would be extended by 2 years until December 31, 2011.

Proposed Change to M&A Taxation

The existing tax deferral on capital gains arising on in-kind contributions is presently limited to corporation establishment. The tax deferral would also be available in the event of capital increases through in-kind contributions. This proposed change would be applicable from July 1, 2010.

Extension of Tax Incentive Period for Factory Relocation to Remote Provinces

The tax law currently provides for the 100% exemption from corporate or individual income tax for the first five years and 50% reduction for the two subsequent years in case where a factory or a head office is relocated from a metropolitan area to a non-metropolitan area. These incentives would be expanded to include the 100% tax exemption for seven years and 50% reduction for three years for the relocation to a more remote province to be specified by the Presidential Decree. However, the existing tax incentives continue to apply for the relocation to five major cities other than Seoul, satellite cities and other pre-designated growing areas near metropolitan cities.

Additions to Knowledge-based Industries

Broadcasting, software development and supply, information service industries would be added to the list of eight existing categories of knowledge-based industries eligible for tax benefits. Mid-size companies located in the metropolitan area engaging in any of the knowledge-based industries are entitled to a 10% tax credit.

Eight categories of the knowledge-based industries include engineering, value added telecommunications, research & development, information processing & other computer operation-related, film or video production, professional design, audit media publishing and advertising material production industries.

Tax Credit for KMS and IT Consulting System Investment

Investment in knowledge management system (KMS) and IT consulting system would be eligible for a 3% tax credit (7% for small and midsize companies), which is presently available for investment in facilities intended to enhance the productivity, including manufacturing process improvement or automation facilities, e-commerce facilities, logistics management and information system, etc.

Proposed Changes to Mandatory Filing of Electronic Tax Invoice

The scheduled mandatory VAT invoicing and filing for individual business operators would be postponed to January 2011, which is one year later than scheduled. However, corporate taxpayers will be subject to the mandatory invoicing & filing of electronic tax invoices as scheduled in January 2010.

When the electronic tax invoice regime is implemented in January 2010, the failure to send the summary sheet to the National Tax Service as required by the law (i.e. by the 10th of the following month from the invoice issuance) would be subject to a 0.5% or 1% penalty rather than a

uniform penalty of 1% as originally intended. A 0.5% penalty would be charged if submitted after the due date, but no later than the 10th of the next month following the end of the taxable period. The penalty rate goes up to 1% if filed later than this.

Eased Criteria for Self-billing

When a supplier of goods or services subject to VAT does not issue a VAT invoice, the self-billing system allows the purchaser to issue and file a VAT invoice and be eligible for input VAT credit by filing it with the tax office.

The self-billing system would be applicable for all transactions rather than the transaction worth KRW 5 million or less per case as required by the current law. In addition, restrictions on the number of and the application due date for self-billing would be eased to ensure that the applications may be filed more than twice a month and within three months (rather than the current 15 days) from the purchase date.

Aggregated VAT Filing

The aggregated value added tax (VAT) filing would be allowed only by filing an application to the National Tax Service. Under the existing tax law, a prior approval from NTS is required.

Fiscal Year of Consolidated Tax Return

Under the new consolidated tax return regime to be enforced in January 2010, the parent corporation's fiscal year must coincide with the fiscal years of its consolidated subsidiaries. However, in case where the fiscal year of the parent corporation as required by the law fails to coincide with those of its consolidate subsidiaries (for example, financial institutions) and statutory audit on its consolidated financial statements is required, the fiscal year of the consolidate subsidiary would be deemed to be the same as that of the parent corporation for consolidation purposes.

Documentation Requirements for Overseas Investment

Domestic companies would be required to submit details on their overseas direct investment and financial information of their overseas subsidiaries in filing corporate income tax returns. The new documentation requirements would be limited to 50% or more-owned overseas subsidiaries. Failure to provide such information may be subject up to fines of KRW10 million.

This requirement is intended to prevent possible abuse of foreign investment as means of tax evasion.

Rulings

Tax Credit for Research and Manpower Development Expenses

Certain allowances paid to employees working in the dedicated research and development department as stated in Article 7, Paragraph 1 of Special Tax Treatment Control Law ("STTCL") may constitute expenditures for research and manpower development, eligible for a tax credit as long as the payment is made by the corporation's pre-set payroll policies. In this context, payment to such employees for their unused paid annual leave pursuant to Article 60 of Labor Law would be considered as labor cost subject to the tax credit as listed in attachment 6 of the STTCL Enforcement Decree. (*Beobgyubeopin* 2009-0241, 2009.7.3)

Recapture of Exempted Taxes in In-kind Contributions

When a new corporation established through in-kind contributions (eligible for acquisition and registration tax exemption on the contributed assets under Article 32 of STTCL) is merged into another corporation within the assessment grace period (2 years), then the originally exempt acquisition and registration taxes will be subject to

recapture. (*Jibangseunyoung*-3013, 2009.7.28)

Under the tax law, acquisition and registration taxes on the acquired assets through in-kind contributions are exempt, but those exempt taxes will be recaptured if the underlying business is ceased or the underlying assets are disposed of within two years from their registration date without any justifiable reason (Article 119, Paragraph 4 and Article 120, Paragraph 5 of STTCL).

VAT Exemption for Re-imports within a Certain Period

When the merger corporation re-imports certain goods, which were previously exported by the merged corporation within two years from their export declaration date, VAT shall be exempt on the ground the exporter and the importer are deemed as the same entity as stated in Article 44, Item 1 of the Enforcement Decree of VAT Law. (*Buga*-1142, 2009.8.13)

VAT Base

In case a domestic corporation that engages in

export of domestic goods receives its sales proceeds in foreign currency prior to its supply, and reimburses its foreign currency-denominated loans and payment for any imported goods with such foreign currency without converting it to KRW, the VAT base in KRW shall be the amount translated using the standard foreign exchange rate at the reimbursement date under the Foreign Exchange Transaction Act as stipulated in Article 51 of the Enforcement Decree of VAT Law. (*Buga*-1122, 2009.8.11)

Existing Tax Incentives for Changed Entity Type

Where a foreign investment corporation qualified for foreign investment tax exemption or reduction under Article 121 Item 2 ② changes its entity type from *Chusik Hoesa* to *Yuhan Hoesa* under the Commercial Codes without any change in its business, the corporation shall continue to be eligible for the foreign investment tax incentives as previously authorized. In this case, an additional application for tax exemption or reduction shall not be required. (*Gukjesewon*-265, 2009.5.28.)

The information contained in this publication is for general guidance on matters of interest only and is not meant to be comprehensive. The application and impact of laws can vary widely based on the particular facts involved. For more information, please contact your usual Samil PwC client service team or professionals listed below.

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Who are small companies ?

- Manufacturing industry with 500 or less employees
- Construction, transportation, storage and telecommunication industry with 300 or less employees
- Other service industries with 100 or less employees

For more about programs and enquiries, please call 02-709-8713 (Rowena Lee)