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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.

- NTS Introduces Horizontal Compliance Program
- Local Consumption Tax to Replace 5% of VAT
- Budget Plan for 2010 to Reduce Corporation Tax
- Number of Tax Audits in 2008 at Record Low for Five Past Years
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NTS Introduces the Horizontal Compliance Program

In October 2009, the National Tax Service (NTS) has introduced the horizontal compliance program. This new program is based on a memorandum of understanding (MOU) between a taxpayer with tax control framework and the tax authorities. Once the MOU is concluded, the tax authorities will monitor the taxpayer's tax control processes and jointly cope with present and possible tax issues with the taxpayer through regular meetings so as to support the taxpayer's faithful compliance.

This program is designed for taxpayers to reduce uncertainties about the interpretation of tax issues and possible compliance and protest costs, enhance the transparency and trust and easily support the reasoning of an underlying tax issue. It is also for the tax authorities to be able to promptly respond to taxpayers' requests and difficulties and achieve a high level of compliance across taxes.

The program will be adopted on a broader scale after a 15-month pilot test starting from October 2009 to December 2010. Outline of the program is summarized below.

Qualifying applicants: Participation in the program will not be mandatory, but voluntary for taxpayers that meet certain conditions. To qualify for the program, 1) a taxpayer must have an internal tax control system and 2) an annual revenue of KRW100 billion or more during the immediate preceding year of the fiscal year for which the agreement application date is included. Note during the pilot test period, the program will be initiated to companies with annual turnover of KRW100 billion to 500 billion governed by the Seoul and Chungbu Regional NTS.

The application must be filed in a prescribed form three months prior to the beginning of the applicant's business year together with documents showing the applicant's business overview and organization-investment details, its internal tax control system, copies of its latest three year financial statements/tax returns, and other documents considered referable.

The NTS will review the filed documents and make an onsite visit before deciding on whether to accept the application. The acceptance or rejection of the application shall be notified to the applicant within three months (one month during the pilot test period) from the application date.

The program will be initiated once the MOU concluded between the NTS and the qualifying applicant. This MOU will be principally valid for a three-year period, beginning from the first fiscal year following the agreement date. The valid period can be reduced through prior consultation between both parties if there is an unavoidable reason. Although it shall comprehensively cover national taxes that the applicant bears liability, the MOU may be applicable to limited number of taxes selected by the applicant. In any case, corporate income tax shall be covered by the MOU.

The MOU will set responsibilities for both NTS and the taxpayer. For example, the taxpayer will be liable to disclose a disputable tax issue and the tax authorities must provide a discussion or a written response (including the interpretation of a tax law) in a timely and accurate manner.

Renewal of the MOU requires the same process with a new application although the on-site visit may be omitted in certain cases as determined by the NTS. The MOU may be cancelled by both NTS and taxpayer if it is impeded by violation of tax laws or any of the prescribed reasons.

Introduction of Local Consumption Tax and Local Income Tax from 2010

The Ministry of Public Administration and Security (MOPAS) has announced its plan to introduce the local consumption tax (LCT) and the local income tax (LIT) in 2010. These local taxes are not a new establishment of taxes, but a partial transfer from the existing valued added tax (VAT). From 2010 5% of VAT (approximately 2.3 trillion won) will be LCT and an additional 5% of VAT from 2013. Imposition and assessment of LCT will be synthetically managed with that of VAT by the NTS. LCT will be distributable to municipal governments based on their private final consumption expenditure along with certain weight per region so as to narrow regional financial gap.

In addition, the existing resident surtax will be replaced with LIT from 2010. When LIT replaces the resident surtax, rules for the tax base and rates will remain unchanged for three years. In 2013, the Ministry will form a task force to develop measures to minimize taxpayers' inconveniences and collection costs.

MOPAS anticipates that LIT will contribute to regional economic growth by enabling local governments to obtain their own monetary resources to promote corporate investment by means of tax policy.

Korean Tax Revenue Plan for 2010 and Tax Revenue Forecast for 2009

The Ministry of Strategy and Finance (MOSF) announced details of the tax revenue plan for 2010. The plan proposes to an increase of tax revenue by 3.9% to KRW171.1 trillion with expectations of economic recovery. The proposed increase in tax revenue is expected to mainly stem from a 22.5% increase in capital gains tax. Capital gains tax is predicted to

increase by KRW 1.6 trillion to KRW 8.9 trillion as the amended capital gains tax regime and the economic recovery is expected to revitalize real estate transactions. As a result of tax rate cuts enforced in 2009, corporate income taxes would be reduced by 2.0% (KRW700 billion) to KRW 35.4 trillion. However, MOSF expects the reduction in tax revenue to be smaller than expected, due to propelled performances driven by export companies. VAT is proposed to increase by 5.0% to KRW 48.7 trillion (or KRW 46.2 trillion if 5% (KRW2.4 trillion) of VAT is transferred to the newly introduced LCT). Wage and salary income tax is expected to increase by 6.2% to KRW 14.2 trillion due to increases in nominal wages and economic growth.

In the meantime, MOSF forecasts the tax revenue for 2009 to slightly exceed the budget at KRW 164.6 trillion. Corporate income tax is expected to be KRW 36.1 trillion, exceeding the original budget by KRW 3.9 trillion resulting from satisfactory 2008 business performances and non recognition of foreign currency valuation losses.

2008 Tax Audit Statistics

The number of tax audits in 2008 decreased by 23% to 14,838 cases as the investigation was temporarily suspended due to economic difficulties triggered by the global financial crisis. This was a record low for the five past years, compared with 19,032 cases in 2007, 22,441 cases in 2006, 25,944 cases in 2005 and 26,526 cases in 2004.

The latest decrease mainly stemmed from a 29% decrease to 2,974 cases in audits on corporate taxpayers. Audits on individual taxpayers decreased by 19% to 3,335 cases, while audits on VAT and capital gains tax decreased by 23% to 3,857 cases and 22% to 4,672 cases, respectively.

Audits on companies were reduced mainly for small and medium size companies since

considered more vulnerable to the economic crisis.

Amidst signs of economic recovery, tax audits in 2009 would be put in place as usual, staying focused on suspected tax avoidance by high-income individual taxpayers, deviated gift and inheritance practices to avoid tax liabilities, as well as suspicion of tax avoidance through international transactions and other irregular transactions.

Rulings

Accounting of Withdrawal of Foreign Currency Deposits in Korean Won

In case a domestic company should withdraw in Korean won from its foreign currency account, the realized gain / loss generated between the actual KRW amount withdrawn and the booked KRW amount (for foreign currency balance), should be reflected in the year that includes the withdrawal date. If the company should partially withdraw from a foreign currency account that has been deposited several times throughout a period, the first in first out (FIFO) method should be used in accounting the withdrawal. However, the moving average method under Corporate Income Tax Law Presidential Decree Article 74, Paragraph 1, Item 1, (e) may be applied in case the company has consistently applied such method as its valuation method. (*Beopin -865, 2009.729*)

Taxation on Gain / Loss Generated from a Post-Sale Settlement Arrangement

In case a domestic company sells its shares of an unlisted company, the gain / loss should be reflected in the year that includes the day fasted among the payment settlement day, the share transfer day or the title transfer day. If the domestic company were to sell its shares at a standard price negotiated between the transaction counterparts, and agreed to settle the difference between market price and the standard price at a certain point after sales, the difference amount should be reflected in the year it is settled.

However, if such transaction is not considered an arm's length transaction for the purpose of selling shares, and rather a transaction to unreasonably reduce tax burden, the share sale shall be subject to Article 52 [Rule for Denial of Unfair Transactions between Related Parties] of the Corporate Income Tax Law. (*Beopin-875, 2009.7.31*)

Tax Incentives for Factory Relocation

In case a small or medium size company that has a factory in the metropolitan area and has been in business for 2 years or more, relocate its head office and factory to a non-metropolitan area, and all remaining factory facilities or land are leased or

an apartment type factory is newly built after removing the old factory, income from the relocated factory will be subject to tax deductions under Article 63, Paragraph 1 of the Special Tax Treatment Control Law. (*Beopin-850, 2009.7.22*)

Timing of the Supply

When a manufacturer supplies its goods to a sales agent and the agent sells the goods to third parties in its own account and responsibility regardless of whether it has paid the manufacturer for the goods, the manufacturer should issue the tax invoice on its delivery of goods to the agent as it is considered the time of supply under Article 9, Paragraph 1 of the VAT Law (i.e. *Timing of Supply*). (*Buga-1273, 2009.9.9*)

Interest Rate on Inter-company Loans

Deemed interest on foreign-currency loans offered to related parties by a domestic company which is not a financial institution shall be calculated based on the loan amount translated into Korea won by applying the basic or arbitrated foreign exchange rate on the date the loans are provided. (*Beopin-931, 2009.8.27*)

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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6 Months	180,000 won	180,000 won	0 won

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)