



Samil Commentary

Korean Tax Update

December 3, 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.

NTS Amends Basic Rulings relating to Corporate Income Tax Law

The National Tax Service (NTS) has amended or created new Basic Rulings (*Gibon Tongchik*) intended to set out the guideline for the enforcement of the changes made to the Corporate Income Tax Law (CITL) since the end of December, 2008. NTS has also amended the rules as necessary to reflect the latest tax rulings issued by the tax authorities.

- *Amended Basic Rulings relating to Corporate Income Tax Law*
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Provided below is a summary of selected amendments:

- Section 15-11...7 stipulates that gain (or loss) on the sale of treasury stock shall be included in taxable income (or deductible expenses) for the concerned tax year, while gain or loss on the retirement of treasury stock is not taxable or deductible. The section, however, does not allow gain (or loss) on the purchase at higher than market prices and the sale at lower than market prices to be included in taxable income (or deductible expenses). A new clause has been added that requires the tax payer to distinguish the acquisition cost of the treasury stock for resale from those for retirement (consistent with the accounting treatment under the Korean GAAP).
- Under CITL, the amount of dividend received deduction (DRD) shall be reduced to the extent of some interest expenses incurred by the shareholder in relation to holding the shares of subsidiaries. In calculating such interest expense amount, the value of the subsidiary shares which are not eligible for DRD shall not be considered, as made clear in the revised Section 18-3-17-3...1.
- Under CITL, the tax payer can write-off checks, notes or other receivables if it passed 6 months or more from the default date except the case where the debtor's property is pledged as a collateral. According to the revised Section 19-2-19-2...7, even in the case the debtor's property is pledged, any excess portion of the debt over the net realizable value of the collateral after deducting any other claims with higher priority can now be written off for tax purposes.

- The new Section 19-2-19-2...10 makes it clear that the tax payer can file an amended tax return and claim a refund/deduction when the tax payer failed to deduct some bad debts (previously disallowed for non-qualification) in the year the statute of limitation for such claim lapsed.
- Section 33-60...2 provides details on the take-over of the severance allowance with respect to the transfer of employees in a business transfer, a merger, or between a parent company and its direct or indirect subsidiaries. This section has been amended to encompass not only employees but executives and the transfer between related parties would also be eligible for the transfer of severance allowance for tax purposes.

15 Companies Selected for the New Horizontal Compliance Program

NTS has selected 15 companies out of 40 applicants for a 15-month pilot test of the horizontal compliance program. Introduced for the first time in Korea in October, this program will be adopted on a broader scale in 2011 after the 15-month pilot test. Selection has been made after reviewing the tax control system and financial data, corporate scale and industry spectrum and considering the proportion of domestic versus foreign-invested companies.

These 15 companies comprise 11 domestic and 4 foreign-invested companies, and in terms of industry, 11 manufacturing companies, one wholesale and retailing company, one fishery company and two other industries.

This program requires a qualifying applicant and the tax authorities to have regular or occasional meetings to cope with the applicant's tax issues, which are put on the table by the taxpayer or the tax authorities. For complex issues, NTS advance ruling and ruling request programs will be utilized to help eliminate uncertainties of the applicant's tax issue.

For details of the program, please see the October 26 issue.

Korea and China Agree to Suspend Transfer Pricing Audits for Years Covered by APA

Korea and China have agreed to exempt Korean companies operating in China from transfer pricing audits by either tax authorities for the fiscal years covered by bilateral advance pricing agreements (APA). Including the first bilateral APA processed between two countries in 2007, there are five such cases.

This agreement was reached during the 14th Commissioner meeting in Seoul between NTS and the Chinese State Administration of Taxation, held in early November. The latest agreement is expected to eliminate transfer pricing audit risk for the covered period and administrative burden of Korean companies doing business in China.

NTS Conducts a Pilot Test of Electronic Tax Invoice System to be Introduced in January 2010

NTS has started a pilot test for the electronic VAT invoicing system (called 'ESERO') two months ahead of the scheduled implementation in January 2010.

The pilot test is now available on the NTS ESERO home (www.esero.go.kr). According to the pilot test, the registered person having an authenticated certificate may issue electronic invoices on the system. Tax invoices may be issued either individually or collectively. The system also allows the registered issuer or receiver to retrieve the issued invoices on the spot and to download the record in the Excel form to search details or the summaries of invoices by seller or by purchaser.

It should be noted that electronic invoices issued on the system during the test period are exemplary ones just for testing purposes. So the existing VAT invoicing practice/requirements would still be effective until the end of 2009.

Suppliers may use application service providers to issue and transmit tax invoices at their own

expenses. Also, large corporation having in-house enterprise resources planning (ERP) systems may have electronic invoicing function embedded to their own system to issue and transmit tax invoices.

The electronic tax invoice system will be applicable to all corporate taxpayers. For the non-compliance with this system (i.e. using paper invoices only), corporate taxpayers will be subject to penalty of 2% of the supply amount.

NTS Advance Ruling Program to Be Amended to Expand its Coverage

NTS will amend the advance ruling program to expand its coverage to individual taxpayers in January 2010. The program is presently available for corporate taxpayers and sole proprietors. The coverage of the program will be gradually expanded to include individual Income tax in January 2010, gift and inheritance tax in July 2010 and capital gains tax in 2011.

Presently, the advance ruling does not cover any inquiries involving a judgment on the facts and circumstances. Under the proposed amendment, an answer would be provided based on the facts and circumstances submitted by taxpayers in response to mixed inquiries requiring a judgment as well as an interpretation of tax provisions.

The advance ruling program was introduced in October 2008 to help taxpayers reduce uncertainties on their tax matters arising from the interpretation of tax provisions and enhance predictability in business operation. According to NTS, a total of 150 inquiries (monthly average of 13) were submitted during the past one year. Answers have been provided to 127 inquiries and 23 inquiries are currently pending. While small and midsize companies and sole proprietors that could not afford to services of professional tax advisors accounted for 62% of the total inquiries, foreign-invested companies used the program regarding tax incentives for foreign direct investment.

The use of the advance ruling program was primarily motivated by taxpayers' recognition of the program

that provided binding answers faster than existing written inquiries. An advance ruling issued by the tax authorities is binding in respect to the specific transaction of which the taxpayer made an inquiry.

Income Tax Treaties between Korea and Columbia, Turkmenistan and Tajikistan

Korea has concluded income tax treaties with Columbia, Turkmenistan and Tajikistan in November and October, 2009. These tax treaties will not be enforced until they are ratified by the parliaments of the respective countries.

Key points of the latest treaties are seen in the table below.

	Columbia	Turkmen-istan	Tajikistan
Duration for construction permanent establishment	Six months	12 months	12 months (6 months for service PE)
Withholding tax rate in the source country			
- Dividends	5%,10%,15% ¹⁾	10%	5%, 10% ²⁾
- Interest	10%	10%	8%
- Royalties	10%	10%	10%
Capital gains tax	Taxed in the residing country with an exception ³⁾		

- 1) 5% if the beneficial owner is a company holding directly 20% or more of the shares of a dividend paying company.
15% if Columbian corporate income tax is exempt.
10% in all other cases.
- 2) 5% if the beneficial owner is a company holding directly 25% or more of the shares of a dividend paying company.
10% in all other cases.
- 3) Capital gains will be taxed in the source country if the transferor has held at least 25% of the total shares of the company in which the transfer is made.

Rulings

Foreign investment ratio in the redemption of preferred stock

When a foreign-invested company has bought back its redeemable preferred stock in accordance with Article 345 (*Redeemable Shares*) of the Commercial Act, the company's foreign investment ratio shall be calculated based on the number of outstanding shares less the redeemed preferred stocks as stipulated in Paragraph 2, Article 121-2 of Tax Preferential Control Law (TPCL) on *Tax exemption or reduction for foreign direct investment*. The provision provides for corporate or individual income tax exemption or reduction for a qualifying foreign-invested company based on the foreign direct investment ratio in the company. (*Jaegookjo-2, 2009.1.5*)

OCS in Thin Capitalization Rules

The Korean thin capitalization rules do not allow interest paid or payable on the amount of borrowings from an overseas controlling shareholder (OCS) in a Korean company in excess of three times the OCS' equity as deductible interest expenses, but regard them as dividend to OCS. OCS refers to a foreign company holding directly or indirectly 50% or more of the Korean company's shares. In case where a Korean company borrows from its OCS, other subsidiary 100% owned by OCS and branches of OCS, and a third party based on the OCS' payment guarantee, the calculation of the disallowed interest expense shall consider the OCS' direct and indirect ownership to the Korean company. (*Jaegookjo-27, 2009.1.22*)

Treatment of Foreign Exchange Gain or Loss in a Series of Facility Investments

When a company makes a series of investments in qualifying energy-saving equipment, foreign exchange gain or loss arising from these investments shall not be included in the amount of investment in computing an investment credit according to Article 25-2 of TPCL on *Energy-saving Facility Investment Credit*. The tax law allows a company to credit 20% of investment in energy-saving facility investment against the company's corporate income tax in a manner as prescribed in the law. In this context, if a series of machineries invested over several fiscal periods cannot function separately in producing goods, the date of the first-of-its kind investment shall be the date the series of investments are initiated. (*Beopin-925, 2009.8.27*)

Prohibition of Multiple Tax Incentives

A company operating two business places under separate accounting as stated in Article 143 of TTCL on *Separate Accounting* would receive a start-up business tax exemption for one business place and a foreign direct investment tax exemption for the other business place. The inquiry was made on whether temporary facility investment credit can be claimed instead of the foreign investment tax exemption when the relevant business place records a loss. In accordance with Paragraph 4, Article 127 of TPCL on *Prohibition of Multiple Tax Incentives*, a company cannot benefit the start-up business tax exemption and the temporary facility investment credit at the same time even though it has two business places with separate accounting records. (*Jaejoteuk-866, 2009.10.8*)

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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Period of education	Cost of education	Employment benefit refund*	Total Cost
2 Months	60,000 won	60,000 won	0 won
3 Months	90,000 won	90,000 won	0 won
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)