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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.

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Update on Tax Laws

Latest Changes in Tax Incentive Rules

Special Tax Treatment Control Law has been amended to reflect the proposed changes contained in the latest tax reform proposals released by the Ministry of Strategy and Finance last September. Effective September 26, 2008, major changes are summarized below:

- When a large corporation pays in the form of a network loan for goods or services purchased from an unrelated small and mid-sized enterprise (SME), the tax credit rate for such payment will increase from 0.3% (3/1000) to 0.4% (4/1000). The credit rate will also increase from 0.3% to 0.4% for payments in cash or cash equivalents between SMEs. The changed rate will be applicable to the payment on or after the effective date of the amendment.
- When a large corporation invests in the shares without voting rights issued by an unrelated SME, dividends received from holding such shares will be 100% deductible to the shareholder. This change will be applicable to the equity investment made on or after the effective date of the amendment.
- The current 7% tax credit rate for research and development (R&D) investment will be increased to 10%, applicable from the fiscal year which includes the effective date of the amendment.
- The tax credit rate for investment in energy saving facilities will increase from 10% to 20%, applicable to the investment made on or after the effective date of the amendment through December 31, 2009. Any investment prior to the effective date would still be eligible for 10% credit.
- SMEs will be eligible for a tax credit of KRW300,000 per worker if they shift the irregular working status of their workers employed as of December 31, 2007 to a regular working status by the end of 2009. The tax credit is applicable from the fiscal year which includes the effective date of the amendment.

Tax Benefit for Project Financing Vehicle to be Retained

Under the existing tax law, project financing vehicles (PFV) are allowed to deduct the amount of their dividend payment against their taxable income if they distribute 90% or more of the distributable income. Although the government's tax reform plan this year proposed the elimination of this benefit, it is determined to be retained in the discussion among the relevant government bodies.

Korea-Australia Social Securities Agreement Comes into Force on October 1, 2008

The social securities agreement between Korea and Australia ('the Agreement') has come into force, effective October 1, 2008 after ten months from the signing of the administrative arrangement between the two governments in December 2007.

The Agreement aims to eliminate a double charge in social security contributions arising when workers move temporarily from one country to the other. Under the agreement, employees working in Korea would generally be covered by Korea and the employees as well as their employers will pay social security contributions only to Korea and vice versa for employees working in Australia.

In the case of expatriates whose assignment to the other country is not expected to last for more than five years, they may be subject to social securities tax in their home country, exempt from social securities taxes in other country in which they are working temporarily.

The Agreement covers contributions prescribed in the Korean National Pension Act and those prescribed in the Australian Superannuation Guarantee Act.

Australia is the 13th country with which Korea has signed the social securities agreement.

Recent Developments in Tax Policies

Korean Government Plans to Reform Local Tax Regime

The Ministry of Public Administration and Security (MOPAS) has announced its plan to reform the local tax regime, which would simplify the existing 16 categories of local taxes into 9 and create a new legislation to take effective control of local tax exemptions and reductions spread among the 16 categories of local taxes. The latest plan would represent a major overhaul of the Korean local tax regime in 48 years. MOPAS will submit its local tax reform bill to the National Assembly at the end of 2008 with expectations of implementing the new local tax regime beginning in 2010.

MOPAS said the local tax regime, which has been developed on a piecemeal basis since the large reform in 1961, is saddled with complex, inefficient and unfair elements and a reform is necessary to create a new local tax regime, which is more efficient, equitable and understandable to taxpayers.

One of the major changes in the reform plan is to overhaul the structure of the local tax code. Presently all the local taxes are governed by a single tax code, which covers general rules, specific local tax provisions as well as tax exemptions and reductions. According to the plan, the existing single tax code would be split into three separate codes, which would deal with each particular aspect such as basic rules governing all local taxes, detailed local tax provisions, and local tax exemptions or reductions.

Another major reform is to redesign the existing local tax regime in a way that improves taxpayer's convenience and reduces administrative burdens. Channels would be created within MOPAS to allow taxpayers a broader access to local tax appeal opportunities. Penalties against belated tax payment would be reduced in certain cases to relieve the taxpayer's burden. Multiple local tax

review committees would be consolidated into a single one to eliminate redundancy.

A separate law would be established to take control of local tax exemptions or reductions, which has been covered by several laws or regulations in addition to the local tax code.

Some of the existing local tax exemptions may be eliminated or reduced, which are deemed no longer adequate due to socio-economic changes or duplicate with other benefits. Some local tax benefits inequitable among similar business lines would also be scrapped or limited.

NTS Introduces Advance Ruling Program in October 2008

Effective from October 1, 2008, the National Tax Service (NTS) has introduced the advance ruling program, which would be similar to the private letter ruling issued by the Internal Revenue Service of the US. This program is intended to help taxpayers reduce uncertainties on their tax matters arising from the interpretation of tax provisions and enhance predictability in business operation.

Under the program, the tax authorities shall provide an answer to a specific tax inquiry, which is raised by a taxpayer in advance of the intended transaction. An advance ruling issued by the tax authorities shall be binding only in respect to the specific transaction, of which the taxpayer made an inquiry. This means that the tax authorities may not be able to challenge a taxpayer for the taxpayer's treatment, which relied on the tax authorities' determination in the advanced ruling. However, the advance ruling would not be seen as binding if it is found to have been obtained with fraud or misrepresentation of the facts of the specific transaction, based on which the advance ruling was issued.

Taxpayer Request for Ruling

Taxpayers registered under Value Added Tax Law, Individual Income Tax Law, or Corporate Income

Tax Law can request for an advance ruling. Non-residents or foreign corporations without having permanent establishments in Korea are also able to request for a ruling under this program. It should be noted, however, that an advance ruling shall be requested by a taxpayer, who is directly involved in the specific transaction concerned (including an entity or individual, who would be liable to pay tax on a prospective transaction).

A ruling request shall be made on a real name basis, along with submission of the relevant information or documents to support and verify the facts and circumstances presented. The request must be made before the statutory due date for the relevant tax filing (for withholding tax, by the 10th of the following month after the relevant taxes are withheld from the payment to the income recipient)

Ruling Coverage

The advance ruling will not cover any inquiries involving a judgment on the facts and circumstances. Some of the illustrative examples are inquiries of whether a specific international transaction would constitute a PE, determination of a beneficial ownership, and whether a specific transaction would be subject to the rule for the denial of unfair trade between related parties. The advance ruling will not be made available for inquiries by a resident in a country or a region from which country no information can be obtained due to the absence of income tax treaty on financial information exchange. No ruling will be issued, either, on an inquiry which presents only some part of a whole and complex transaction.

Rulings

VAT Ruling on Time of Supply

A question was raised on the timing of transaction (or supply) in the case that there is an arrangement between an export agent and an exporter, under which the agent would receive commissions from the exporter when the purchaser of the relevant goods actually makes the payment. This was due to the agent's responsibility for handling claims, returns and collection after the shipment. For the case in question, a recent ruling provides that the provision of the export agent's service shall be treated as "other conditional service" as prescribed in Item 2, Article 22, Enforcement Decree, Value Added Tax Law. According to the law, for "other conditional services", the time of supply (or the service provision) is the point when the relevant consideration is to be paid/ received as agreed between the two contracting parties (*Buga-3106, 2008.9.18*).

Exemption from Acquisition Tax and Registration Tax for Consecutive Spin-offs

There was a business divestiture where a new company created through a spin-off from an existing company (first spin-off) spins off the same business to create another new company (second spin-off) within five years from the first spin-off, and a question was raised whether the second spin-off could be a qualified one, eligible for the exemption from acquisition and registration taxes under the relevant tax law.

Under the tax law, the exemption of acquisition and registration taxes in a qualified spin-off requires the satisfaction of the three conditions below:

1. the concerned business to be spun-off should have been in operation by a domestic company for at least five consecutive years prior to the date of the court registration of the

spin-off;

2. The consideration for the spin-off is paid to the existing shareholder of the original company all in the form of the shares of the new company in proportion to their shareholding ratio to the original company
3. The new company continues the concerned business at least to the end of the fiscal year which includes the date of the court registration of the spin-off

For determining whether the second spin-off is qualified for the tax exemption, the five year period in condition (1) shall consider the period of operation performed by the original company and in order for this second spin-off to meet this condition, the original company should have run the operation of the relevant business for at least 5 years prior to the first spin-off (*Jibangseunyoung-3, 2008.5.20*)

Equity Linked Warrants not subject to Securities Transaction Tax

A ruling provides that equity linked warrants (ELW) are not included in the scope of the "securities" subject to securities transaction tax as prescribed in Clause 1, Article 2, Securities Transaction Tax Act. Thus, a transfer of ELW would not be subject to securities transaction tax (*Jaesan-2417, 2008.8.22*)

According to the law, securities transaction tax is imposed on the transfer of i) stocks of a corporation established under the Commercial Act or any special law; and ii) stocks or depository receipts issued by a foreign corporation, which are listed or registered for trading in the stock market.

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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