



# Samil Commentary

Korean Tax Update

August 31, 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.*

## Rules Amended to Expand Foreign Direct Investment Incentives

Effective on July 31, 2009, the enforcement rules of the Foreign Investment Promotion Act have been amended to expand foreign direct investment incentives as follows:

- Rules Amended to Expand Foreign Direct Investment Incentives
- Korea to Reform Bonded Factory Regime
- Plan to Enhance the Predictability of Tax Audits
- Electronic Local Tax Payment Launched in August
- Local Tax Payment System to Be Overhauled

### Rulings

- Deductibility of Input Tax on Payments to Domestic Financial Advisor in relation to Overseas Project
- Unlisted Share Valuation Method
- Acquisition cost in capital reduction of a foreign shareholder

- Foreign investment companies will be eligible for cash grants as long as they meet the requirements for creation of new employment. The new employment thresholds for cash grants are 300 full-time employees in the manufacturing, mining construction, transportation, telecommunication and information service industry and 200 in the banking, insurance or retailing or & wholesaling industry.
- Charges on leased land will be 100% (rather than 75%) exempt for foreign investment companies as long as their foreign direct investment amounts to USD 5 million or more and they are located in special zones exclusively developed for strategic parts and materials manufacturers.
- In an effort to attract foreign direct investment to facilitate local economic development and create employment, municipal governments may provide financial support on land purchase and construction costs in connection with new or additional foreigner schools to be built in their regions.
- Foreign private equity funds will be restricted from directly or indirectly acquiring shares in domestic companies engaged in specified industries which are subject to restriction on foreign direct or indirect investment.
- The Foreign Investment Working Committee led by the Vice Minister of the Ministry of Knowledge and Economy will be empowered to authorize the change or cancellation of designated foreign investment zones in order to enhance the Foreign Investment Committee's operation effectiveness.

## Korea to Reform Bonded Factory Regime

The Customs Service has announced a series of measures to reform the existing bonded factory regime in an effort to help strengthen the competitiveness of export-oriented manufacturers. The latest reform measures expand the scope of goods and operations eligible for bonded factory incentives, streamline the regulatory customs clearance procedures in a way to enhance the price competitiveness of goods manufactured or processed in bonded factories and move away from physical control over the movement of goods to the computerized system.

According to the amended Notice for the Operation of Bonded Factories issued by the Customs Service, effective August 31, 2009, the bonded factory incentives, which have been available for traditional manufacturing and processing, would be granted to inspection, sorting, assembly and packaging etc. as well.

The amended notice introduces customs duties comprehensive imposition request system on clearance of goods manufactured in bonded factories for domestic use. The customs duties comprehensive imposition request system comprises foreign raw materials used for manufacturing goods in the bonded factories by raw material, goods or bonded factory when requesting for application of comprehensive customs duties imposition thereon. The new system would have the effect of enhancing price competitiveness of goods manufactured in bonded factories by lowering dutiable prices.

Also, the amended notice allows shipment of goods manufactured or processed in a bonded factory to other bonded areas or factories even while customs offices are closed. This is to support industries such as LCD-semiconductor industry that operate non-stop production lines and transportation systems.

## #1 Korea tax business

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These results are based on the year-ending Q2 2009 figures, with a sample size of 100 primary buyers of tax advice in Korea.

Launched in 2000, the Global Tax Monitor (GTM) is a multi-client independent survey conducted by research agency TNS, that examines the competitive position of the top firms in the tax advisory market - globally, regionally, nationally and on an industry basis. It provides a comprehensive measure of firm reputation, client service and brand health, gained currently from just over 3,000 telephone interviews annually with key decision makers (CFOs and Tax Directors) in 31 key markets.

In addition to the above, the Customs Service has proposed additional reform measures as below:

- Bonded factory incentives on raw materials which defer assessment of import duties thereon will be extended to those used for bioengineering goods nurtured by pharmaceuticals and life science industries.
- Reduce customs office's direct control (such as elected inspection of reported goods, periodical inventory audits, etc.) over bonded factories by applying the enterprise resources planning (ERP) system which would lessen corporate burden while enhancing the effectiveness over bonded freight control.

Measures other than those applicable through the above amended notice will be proposed for enforcement in 2010 through consultation with the relevant authorities.

### **Plan to Enhance the Predictability of Tax Audits**

The National Tax Service has revealed its plan to shift the way of conducting tax audits to a four-year cyclical approach from the current five-year audit cycle for large companies having turnover of 500 billion won. This plan is to ensure that tax audits may be conducted in a predictable manner. It is expected that the four-year cyclical audit approach would apply to selected audit targets in September 2009. For small and midsize companies, the audit selection criteria will continue to be based on the taxpayer compliance evaluation.

In addition, the NTS plans to introduce the taxpayer advocate service. When taxpayers' rights and interest are found to be threatened significantly the taxpayer advocate will be empowered to request the suspension of ongoing tax audit, the replacement of audit team or the disciplinary action against auditors.

In the meantime, in-advance notice of tax audit and request for delay of tax audit have been enforced since January 2007 as part of schemes to protect taxpayer rights. The Korean tax law presently requires the tax authorities to notify a taxpayer of a planned tax investigation 10 days before the commencement of audit procedures. When a taxpayer files with the tax authorities a request for delay of tax audit, they must notify the taxpayer of their decision on whether the request is accepted. The tax audit procedures shall not commence before such notice is given to the taxpayer.

### **Electronic Local Tax Payment Verification Launched in August**

The Ministry of Public Administration and Security has launched the local tax payment verification system, WeTax. Effective on August 3, 2009, the system allows taxpayers to retrieve their electronic receipts on their local tax payments made through the system as well as onsite payment.

Electronic tax receipts may be retrieved by visiting WeTax at [www.wetax.go.kr](http://www.wetax.go.kr), using personal security certificate authorized by a financial institution to login. Tax receipts will be issued free of charge.

Under the electronic payment system, individual taxpayers are no longer required to keep local tax payment receipts for five years.

### **Local Tax Payment System to Be Overhauled**

The Ministry of Public Administration and Security has recently announced a series of proposals to overhaul the local tax payment system. One of the proposed measures would introduce a standard service agreement between all municipal governments as one unit and all financial institutions whereby financial institutions accept overall payment of local taxes in proxy of

the municipal governments. On implementation, payment services may be available for taxpayers regardless of where they reside, their main transaction bank and which credit card they use.

Another proposal is to create and operate a tax payer based local tax return which will be made possible by establishing a “unified tax payment system” linked to WeTax. When implemented, the unified tax payment system will replace the existing system which requires corporations to file and pay resident surtax (additionally charged at 10% of corporate income tax) and business place tax at the relevant tax office where its branches are located. Under the unified tax payment system, the head office will file and pay the total amount of such taxes on behalf of its branches to the relevant tax office. On payment, the payment amount will be systematically allocated according to the pre-set criteria, through the unified tax system to each municipal government.

## Rulings

### **Deductibility of Input VAT on Payments to Domestic Financial Advisor in relation to Overseas Project**

A domestic company intends to raise funds from domestic financial institutions jointly with an overseas subsidiary to finance an overseas real estate development project carried on by the overseas subsidiary. In relation to the joint project financing, the domestic company would conclude a consulting service agreement with a domestic financial advisor in relation to financing of the overseas real estate development project and make payments to the domestic financial advisor in return for the consulting service.

In this case, payments for financial advisory service shall be treated as expenditures incurred not directly related to the taxpayer’s taxable business as prescribed in the Value Added Tax (VAT) Law, Article 17, Paragraph 2, Item 2 and thus shall not be deductible. However, in determining the right tax treatment,

comprehensive consideration shall be made on facts and circumstances, such as the party taking substantial control of the overseas real estate development project, business scope of the domestic company, etc. (*Beopgue-915, 2009.76*)

### **Unlisted Share Valuation Method**

In the absence of fair market value, the Inheritance and Gift Tax Law (IGTL) provides that the valuation of shares of an unlisted company shall be made on the weighted average of net profit value and net asset value with an exception to unlisted companies that have been in operation for less than 3 years since its business commencement. Shares of such unlisted companies shall be valued by its net asset value only.

In regard to the above, the latest ruling issued by the Ministry of Strategy and Finance (“MOSF”) states that the three-year test shall be based on the business commencement date of the carved out division rather than the business commencement date of a new company created in a spin-off as long as the spin-off meets certain conditions as prescribed in Article 47, Paragraph 1 of the Corporate Income Tax Law (“qualified spin-off”) (*Jaejaesan-1065, 2009.6.15*)

MOSF’s prior rulings took a different interpretation on the business commencement date per split type. However, considering that i) the rights and responsibility of the division is comprehensively succeeded and maintained in either case of a spin-off and a split-off, ii) only the recipient of the newly issued share differs and iii) Corporate Income Tax Law treats spin-offs and split-offs equally, the business commencement date in case of a spin-off has been newly interpreted as the business commencement date of the identical business division prior to the spin-off, same as the existing treatment on split-off.

## Acquisition Cost in Capital Reduction of a Foreign Shareholder

In case a foreign corporation that does not have a permanent establishment (PE) in Korea is imposed with acquisition tax under Korean Local Tax Law ("LTL") being a majority shareholder by way of acquiring shares of a domestic company, such acquisition tax amount shall be considered

as cost directly incurred in regard to the acquisition of shares and thus included in the acquisition price. Also, where the consideration received by the foreign shareholder in respect to capital reduction of the domestic company is less than the shareholder's cost generated when acquiring the relevant shares, the difference shall be included in the acquisition price of the remaining shares. (*Jaegukjo-334, 2009.7.21*)

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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