PRICEWATERHOUSECOOPERS

Samil Commentary
Korean Tax Update
Samil PricewaterhouseCoopers

September 15, 2008

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.

Korean Tax Reform Proposals for 2008

The Korean government has announced a package of proposed changes to tax laws including reductions in corporate and individual income tax rates, withholding tax on interest and dividends paid to nonresidents and foreign corporations, and branch tax on foreign corporations. If the proposed changes are approved by the National Assembly in December, most of the proposed changes would become effective starting January 1, 2009 unless otherwise be specified.

Provided below is a brief summary of significant changes contained in the reform package released by the Ministry of Strategy and Finance.

Tax Rate Cuts

Corporation Tax: According to the proposal, the corporate income tax rates would be 11% on the taxable income of up to KRW200M and 25% on the excess in the fiscal year which includes the date of enforcement. The rates would be adjusted to 11% and 22% in the fiscal year immediately following the year of the enforcement date, and further be reduced to 10% and 20%, respectively, afterwards.

Alternative Minimum Tax: In line with the proposed two-phase reduction in corporate income tax rates, alternative minimum tax rates will also be lowered. Under the proposed change, alternative minimum tax which is currently 13% for the tax base of up to KRW100 billion (15% for the excess) before applying various tax credits and attributes, may be reduced to 11% (and 14%) for FY2008 and FY2009. The rates would be further reduced to 10% (and 13%) from 2010. For small and mid-size enterprises (SME), the rates would be reduced from 10% to 8% before applying various tax credits and attributes for FY2008 and FY2009 and to 7% from FY2010.

Withholding Tax: Withholding tax rates for dividends and interest paid to nonresidents or foreign corporations would be reduced from 25% to 20% for payments to be paid on or after January 1, 2009. However, interest and dividends received by a nonresident or a foreign company based in a foreign country with which Korea has an income tax treaty continue to be subject to the reduced treaty rates.

ⓒ 2008 Samil PricewaterhouseCoopers. All rights reserved. "PricewaterhouseCoopers" refers to the Korean firm of Samil PricewaterhouseCoopers or, as the context requires, the other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Branch Profit Tax: Branch profit tax which is levied in addition to the regular corporation tax would be reduced from 25% to 20% of the adjusted taxable income of a foreign corporation from the fiscal year beginning on or after January 1, 2009.

Proposed Changes to Personal Income Tax

Individual income tax rates on aggregate income which currently range from 8% to 35% would be reduced by one percentage point to 7% (for annual taxable income of KRW 12 million) to 34% (for taxable income exceeding KRW 88 million) from FY2009. The rates would be lowered by another one percentage point to 6% to 33% from FY2010.

In an effort to attract highly skilled workers, a change is proposed to income tax rate for foreigners' salary income. Currently, 30% of salary paid to foreign expatriates or employees working in Korea are not taxable in Korea. Furthermore, foreign expatriates and employees can choose to apply a flat income tax rate of 18.7% (including resident surtax) on their salary income earned in Korea. If chosen, the 30% deduction of salary income, any other income deductions, tax exemption, and tax credit are forfeited. The flat income tax rate of 18.7% would be lowered to 16.5% under the proposal.

In order to promote hiring of foreign talents, two changes are proposed. One of the proposed changes would reduce the taxable scope of income received by foreign employees with a short-term assignment. Foreign employees would only be taxed on foreign sourced income received in Korea or remitted into Korea however; they will still be subject to tax on Korean sourced income.

The other change would limit the scope of foreign taxpayers to include foreign employees who have resided in Korea for at least five years during a 10 year period. Currently, individuals who have domiciles in Korea or have resided in Korea for at least one year, irrespective of their nationality, are entirely subject to income tax on their Korean sourced income as well as foreign sourced income

Support for SMEs

The proposed reform package would extend the period or expand the eligible scope for existing incentives as follows:

- Star-up SMEs established in non-metropolitan areas currently receive 50% reduction in corporation income tax for the first four taxable years as long as they engage in any of 23 pre-designated businesses including manufacturing business. This incentive would be extended to cultural activities, construction, restaurant, and exhibition businesses.

- The existing 10% to 30% tax credit for small companies (5~15% for medium companies) which was to be no longer available by the end of December 2008 would be extended for three additional years until the end of December 2011.

- In case where a tax liability of a SME exceeds KRW10 million, such SME will be able to pay the liability in two installments. The second installment is due within two months from the original payment due date instead of 45 days as under the current law. The installment payment also applies to corporate, individual, or gift and inheritance taxes.

Proposed Changes toward Global Standards

- A consolidated tax return system would be introduced from 2010, allowing taxpayers to elect the current separate tax return filing system or the proposed new system *(For details, please see the Korean Tax Update, July 31 2008 issue.)*

- The presently allowed net operating loss (NOL) carryover of 5 years will be extended to 10 years. This proposed change would be applicable to NOL generated from fiscal years beginning on or after January 1, 2009.

- Under the proposed change, value added tax (VAT) would be imposed based on a VAT registration of a taxpayer rather than VAT registration of a business place. Currently, VAT is generally due on a supply of goods or services by a business place which is registered for VAT, requiring a taxpayer having more than one business place to make payment and filing of VAT for each business place. The taxpayer-based VAT system is only permitted for a taxpayer with an enterprise resource planning (ERP) system and a prior approval from the tax office in the applicable jurisdiction.

  The proposed new system offers a one-year grace period from fiscal years in which January 1, 2010 falls so that taxpayers have sufficient time to prepare for the newly proposed system.

- Dividends received deduction (DRD) of 30% to 100% is currently granted based on an equity ratio of a subsidiary with a limitation imposed in case of a dividend paying subsidiary investing in an affiliate of the dividend receiving company. This limitation would be eliminated to ensure that DRD would be granted even in case of an investment in such an affiliate.

Proposed Changes to Rules on Tax Incentives

The tax law currently provides for a 7% tax credit with respect to investment in facilities designed to preserve environment. From January 1, 2009, 10% of such investment would be credited against the taxable income for the concerned tax year.

The 10% tax credit for investment in facilities designed to save energy would be increased to 20% and extended for one more year until the end of December 31, 2009. The 10% credit continues to apply to investments made before the proposed change is enforced.

When assets produced or acquired outside Korea are transferred or sold in Korea by a foreign corporation, 2% withholding tax is currently imposed at the time payment is made. Under the proposed law, such withholding tax would be removed in case where such assets are transferred or sold in Korea after having been kept in a bonded warehouse.

Income arising on investment vehicles to be established under the new legislation on capital market and investment bank would be taxed as dividends to investors. This change would apply to income arising on or after February 4, 2009 when the new law becomes effective.

When partnership taxation is implemented in January 2009, private equity funds can also be subject to partnership taxation.

Gain from indirect investment vehicles is presently taxed as dividend to investors by settlement of accounts at least once a year. Under the proposed change, gain on the evaluation of invested assets would be taxed at the time of settlement or at the time of repurchase at a taxpayer's own discretion.

De minimis expenditure to purchase eligible goods below KRW 5,000 threshold would be treated as advertisement expense which will be fully deductible, regardless of whether or not the purchased goods are provided to many unspecified individuals.

Sales, general, and administration (SG&A) expenses which are not treated as entertainment expenses are more specifically defined to include expenditure made according to an advance agreement and deemed as an ordinary

transaction. Even in absence of an advance agreement, expenditures meeting any of prescribed criteria would be treated as SG&A expenses.

Anti-tax Haven Rule

The anti-tax haven rule does not apply to a company engaged in wholesale business if the following condition exists: 50% or more of purchase and sales relating to the wholesale business is derived from transactions with a related party engaged in the manufacturing business in the same region or territory where the wholesale business operates. Under the proposed amendment, related-party sales requirements for the exemption from the anti-tax haven rule would be removed while related-party purchase requirements remain.

According to the anti-tax haven rule, accumulated earnings (distributable retained earnings) of a foreign company located in a low tax jurisdiction, where effective tax rate on taxable income for the past three years average 15% or less, are taxed as deemed dividends to Korean residents which have direct and indirect interest of 20% or more in the foreign company.

R&D Tax Credit

The following changes are proposed to facilitate research and development (R&D) activities:

- R&D reserve would be deductible up to 3% of gross sales amount. A portion of the R&D reserve actually incurred during the year would be added back to gross income in three yearly installments after a grace period of three years. The proposed tax relief would be available for five years until the end of December 2013.

- The 7% tax credit for investment in R&D facilities would be increased to 10% of the investment.

- Qualified R&D expenditures by a SME are currently eligible for tax credit. Investment to be credited is limited to: i) 15% of the expenditures for the respective year or ii) 50% of an increment in R&D expenditures for the concerned tax year from the average amount of such expenditures for four preceding years.

  Under the proposed change, the 15% tax credit rate would be increased to 25% while no change is made to the limit in ii). This tax relief, originally planned to expire in December 2009, would be permanently made available.

Education Tax on Financial Service Companies

Banking and insurance businesses are currently liable to pay education tax of 0.5% on their gross receipts. The education tax would be eliminated, and banking and insurance businesses would be liable to pay a 10% VAT on their gross receipts from January 1, 2010.

In addition, the tax liability scope would be expanded from banking and insurance businesses to include securities companies, futures traders, credit card companies, leasing companies as well as installment sales financing businesses, and Korea Exim Bank from January 2009.

Reduction in VAT-exempt Supplies

VAT-exempt supplies will be reduced to comply with global standards from July 1, 2009. Details would be included in a bill to amend the Enforcement Decree of the VAT Law which is expected to happen at the end of December 2008. Under the current law, main types of VAT-exempt supplies include supplies of daily goods, education, medical, and certain financial services.

Penalties on Amended Returns

Penalties imposed on underreported income is presently reduced by 50% if a corporation files an amended tax return and pays taxes within six months from the due date for the tax return. The reduction rates would be determined based on a number of days that an underpaid tax liability remains outstanding , i.e. 20% for a period over six months not exceeding one year and 10% for a period of more than one year not exceeding two years from the original due date. The reduction rates would apply to penalties such as failure to pay, failure to report, underpayment, underreporting, and overreporting penalties.

In case of underreporting or underpayment penalties due to transfer pricing adjustment based on arm's length price, such penalties may be exempt when the taxpayer retains and attach documentations supporting the arm's length price calculation method the taxpayer adopted in filing its corporation tax return.

Due Date for Payment of Capital Gains Tax

In case of unlisted stock sales, securities transaction tax or capital gains tax on such sale would be due within two months from the end of a quarter in which the transfer date falls. Under the current law, securities transaction tax is due on the 10th day of a month following the transaction month.

Mandatory Filing of Electronic Tax Invoices

Taxpayers of certain size and scale including corporate taxpayers and taxpayers subject to double-entry bookkeeping requirement would be obliged to issue electronic tax invoices which would replace hard copy invoices. Such taxpayers would have to send via online a summary sheet of invoices issued by the 10th of a month following the month electronic invoices are issued to the National Tax Service (NTS). Failure to comply with the electronic invoice requirements would be subject to a penalty equaling 1% of purchase/supply prices. With respect to electronic invoices submitted online to the NTS, taxpayers would be exempt from requirements of filing summary sheets for tax invoices by supplier or by purchaser at the time of filing VAT returns.

In addition, an amount of KRW100 per electronic invoice would be credited against tax liability with a limitation of KRW1 million a year.

The mandatory electronic tax invoice system would be implemented when the NTS online system is completed in 2010.

Tax Incentives for Special Zone Investments

Two changes are proposed in relation to tax incentives for investment in special zones. According to one of the proposed changes, tax incentives for development projects in the Cheju Investment Promotion Zone, which are limited to certain eligible foreign investors, would be granted to local developers in an effort to promote joint investments between foreign and local developers in the special zone. A local developer would receive a 50% reduction in corporate income tax for the first three years and a 25% reduction in the two subsequent years in respect of any project costing KRW100 billion or more.

The other change would lower a minimum capitalization requirement for a foreign-invested research and development (R&D) business located in a 'Development District of Enterprise New Town' to US$2 million from US$5 million. Any qualified company in this special district would receive tax incentives including the 100% exemption from corporate income tax for the first five years and 50% reduction for the two subsequent years. For local R&D investors in the zone, the minimum capitalization requirement would be lowered to KRW2 billion from KRW5 billion.

Copyright©2008 Samil PricewaterhouseCoopers

Extension of Tax Relief for Relocation

The existing tax relief for relocation of a head office or a factory into non-metropolitan areas or rural areas would be available for three more years until the end of December 2011. The tax reliefs include the 100% exemption from corporate or individual income taxes 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 rural area. For relocations of a factory or a head office from a large city to a local area, capital gains tax arising on the sale of head office buildings or factories in a large city may be paid in five annual installments after a grace period of five years.

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.

David Jin Young Lee	82- 2-709-0557	jylee@samil.com
IlHwan Oh	82-2-709-0897	ih_oh@samil.com
Dong-Keon Lee	82-2-709-0561	dklee@samil.com
Dong-Bum Kim	82-2-709-7900	dbkim@samil.com
Sang-Keun Song	82-2-709-0559	sksong@samil.com
Alex Joong-Hyun Lee	82-2-709-0598,	alexlee@samil.com
Henry An	82-2-3781-2594	henryan@samil.com
Shin-Jong Kang	82-2-709-0578	sjkang@samil.com
Sang-do Lee	82-2-709-0288	sdlee@samil.com

Copyrightⓒ2008 Samil PricewaterhouseCoopers