

Tax News Flash

September 2009



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Tax Reform Proposal for 2010

The Ministry of Strategy and Finance (“MOSF”) has announced on August 25, 2009 its tax reform proposal for 2010. The basis of this proposal is to enforce lower tax rates as planned, extend R&D support in order to promote job creation and economic recovery, and to stimulate structuring while seeking ways to recover the shortage of tax revenue. We have summarized some of the major items in the reform proposal as follows.

Tax Incentives for R&D and Green Energy Investment

- Companies are presently to claim a tax credit in relation to qualifying R&D expenditure. The calculation of this credit is to be extended to include R&D in relation to ‘core technologies’ as authorized by government ministries. Furthermore, the rate of the credit will increase to 20% or 25% of qualifying spend (30% or 35% for small and medium enterprises (SMEs)).
- The sunset for research and human resource development credit, a 10% credit on investment in R&D facilities and vocational training facilities, will be extended for 3 years until December 31, 2012.
- Investment in green technology facilities (new or renewable energy, low carbon energy, LED, etc) will be added to the scope of energy saving facilities, which are presently entitled to a 20% credit, compared with a 10% credit for general investment in facilities. The sunset for the investment tax credit on energy saving facilities will be extended for 2 years until December 31, 2011 and the credit will be limited up to 30% of the corporate tax liability.
- Corporate or individual income tax for a start-up SME involved in new energy-related technology industries will be reduced by 50% for up to 4 years.
- The existing tax credit (between 5% and 30%) for SMEs will be extended to Energy Saving Companies (ESCO), which install energy saving facilities for other companies in need of technology and capital investment.
- Dedicated funds for the promotion of investment in the green industry (“green funds”) will be created. Public investors will be allowed a tax deduction against taxable income equal to the lesser of 10% of their investment in qualifying green funds or KRW3m per fiscal year. Dividend income received from such funds will be exempt from tax and contributions per investor are limited to KRW30m. A qualifying green fund must invest at least 60% of its assets in securities issued by a certified green energy project or service companies and operate for a minimum period of three years.
- A green technology certificate program will be introduced to permit income tax reduction for investment in certified green technologies or projects. Details of the program will be made available by the government task force team in the fall of 2009.

Stimulation of Corporate Restructuring

Although there are a variety of ways to perform restructuring, the absence of any tax benefits to support such transactions have been considered an obstacle in encouraging corporate restructuring. In an effort to diversify ways of corporate restructuring and simplify taxation thereon, MOSF has proposed the following, which may be applicable from July 1, 2010, if the bill is passed by the National Assembly later this year.

Types of transactions considered as M&As will be extended, enabling companies engaged in such transactions to be eligible for tax benefits or deferrals. Under the proposal, comprehensive share exchanges, and comprehensive asset transfers will be eligible for the existing M&A taxation i.e. corporate income tax, dividend income tax will be deferred and taxed later on and securities transaction taxes will be exempt. Assets eligible for tax deferral on its capital gains will be extended to all assets while under the current merger and split-off taxation system, only tangible fixed assets used for business purposes are tax deferred until disposition.

However, in order to prevent tax evasion through M&As, requirements for corporation's substantial consistency after M&A, which is key in determining eligibility of tax deferral, will be strengthened as follows: shareholder of the merged company will be required to hold the shares for a certain period; merging company will be required to hold ½ of the merger acquired assets for a certain period.

Reduction of Tax Benefits for Large Companies

- Alternative minimum tax rate for 2010 would be adjusted upward from 10% to 13% for large companies with tax base of KRW10 billion and from 13% to 15% for large companies with tax base of KRW100 billion. This upward adjustment of AMT rate for large companies is intended to compensate the expected loss of tax revenue arising from the overall reduction of the corporate income tax rates (i.e. from 25% in 2008 to 22% and 20% in 2009 and 2010, respectively). The government expects that around 1,000 corporate tax payers may be affected by this measure of AMT rate increase.
- The government decided not to extend the sunset clause for temporary tax credit on facility investment, which is scheduled to be terminated as of Dec. 31, 2009. According to MOSF, large companies are major beneficiaries for this tax credit, which have been in place for over 20 years, and particularly, 10 large companies have been claiming 54% of the total credit benefit.

Others

- The current 5-year corporate income tax exemption on qualified royalty income obtained by foreign corporations by providing high technology to domestic corporations will be repealed.
- Statutorily audited corporations (i.e. CH companies with assets of KRW 10 billion or more as of its prior fiscal year and listed corporations) will be eligible for corporate income tax filing extension up to 1 month with due application. However, interest of 0.03% per diem will be imposed for the extended period.
- For the purpose of applying the thin capitalization rule, Korea branches of foreign banks may choose to translate its foreign currency loan into KRW by using either the standard rate as of the fiscal year-end or the daily foreign exchange rate. Once chosen, the same method shall be applied for the following 5 years.