

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.

Update on Tax Laws

- Proposed Reduction in Corporate Income Tax Rates
- Korea-Latvia Agreement on Income Tax Treaty

Recent Developments in Tax Policies

- Liberalization of Investment in Overseas Real Property
- Expansion of Ceiling on Joint Cash Management Overseas

Ruling

- Treatment of Considerations for the Use of Unregistered Patents
- Treatment of the Issuance of Exchangeable Bonds

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Tax Laws

Proposed Reduction in Corporate Income Tax Rates

The Ministry of Strategy and Finance (MOSF) has announced its plan to amend tax laws to reduce corporate income tax rates, intended to reverse the recent slowdown in the Korean economy. The plan also includes expanding the existing tax credits for investment in research and development (R&D) facilities as well as R&D expenditure.

The proposed amendments to tax laws will be submitted to the National Assembly at the end of June. Provided below is a brief summary of proposed amendments to tax laws.

Corporate income tax rate cuts The corporate income tax rates are currently 13% on the tax base of up to KRW100 million and 25% for the excess. Under the plan, the corporate income tax rates would be reduced to 11% on the tax base of up to KRW200 million and 22% for the excess from FY 2008. As the second phase, it is also proposed that the rates would be further reduced to 10% and 20% from FY 2010.

If approved by the National Assembly in June, the proposed tax rate cuts would be applicable from the interim tax return for FY2008.

Alternative minimum tax rate cuts. In line with the proposed two-phase reduction in corporate income tax rates, alternative minimum tax rates are also to be lowered. Under the proposed plan, 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 FY 2008 and FY2009. The rates would be further reduced to 10% (and 13%) from FY2010.

The alternative minimum tax for medium and small-sized enterprises (SME) will be lowered from 10% to 8% on the tax base before applying various tax credits and attributes for FY2008 and FY2009 and then further reduced to 7% from FY 2010.

If approved by the National Assembly in June, the proposed tax rate cuts would be applicable from the interim tax return for FY2008.

Expansion of Tax Credit for R&D Investment

Tax credits available for investment in facilities to be used for research and development (R&D), occupational training or commercialization of new technology will increase from 7% to 10% of the investment amount. The increased tax credit will be applicable from FY 2008.

Expanding the Scope of R&D Expenditure Eligible for Tax Credit

The existing tax credit for R&D expenditure will be made available to 1) payments to non-employees for rewarding their innovative works and 2) payments to purchase scientific and technology publications.

Dividends Received Deduction Under the tax law, dividend received deduction is allowed to the corporate shareholders who receive dividends from a domestic corporation. The DRD amount is limited to 50% for ownership interest of more than 50% and to 30% for share ownership of 50% or less.

Under the proposed plan, a 100% deduction may be allowed for the dividends received by a large corporate shareholder from an SME if certain conditions are met, i.e. the distributing company is an SME under Act on Promotion of Mutual Cooperation between Large Corporations and SMEs and a large corporation invests in SME shares without voting rights by December 31, 2010.

Once passed by the National Assembly, the proposed 100% DRD will be applicable to dividends received from the ownership interest invested on or after the effective date of the new provision.

Tax Credit for Promoting Job Creation A tax credit for employment of non-regular workers is newly proposed to promote job creation. According to the proposal, an SME would be allowed to credit KRW300,000 per person

against its corporate income tax due for the concerned tax year if it turns the status of non-regular worker (employed as of the end of December 2007) to regular. The proposed tax credit would be available to the change of working status made by the end of December 31, 2009.

Once passed by the National Assembly, the proposed tax credit will be applicable from FY 2008.

Tax Credit for Investment in Recreation and Resort Industries

The subject industry eligible for Temporary Tax Credit on Investment may include recreation and resort industries. Under the proposed plan, those industries may be allowed to benefit a 7% tax credit on their investment in certain facilities, e.g. hotels and resorts, amusement or sports facilities (except for restaurants and golf courses). Once passed by the National Assembly, the tax credit would be available for investments made from FY 2008.

Korea and Latvia Sign an Income Tax Treaty

Korea and Latvia signed an income tax treaty in Seoul on June 15, 2008. The agreement is the first income tax treaty signed between the two countries. The agreement will come into force after it is ratified by the parliaments of both countries.

Under the treaty, dividends will be subject to 5% withholding tax if the recipient is the beneficial owner, holding at least 25% direct ownership of the dividend distributing company. 10% withholding tax rate will apply in other cases. For interest income and royalties, withholding tax will be limited to 10%.

Capital gains derived by a resident of a contracting state from the sale of shares issued or assets (except real property) owned by a company in the other contracting state will be taxable only in the state of residence. In

addition, the treaty contains limitation on benefit, which is intended to prevent the application of the treaty benefits for treaty shopping purposes

Recent Developments in Policy

Deregulation on Investment in Foreign Real Property

The Foreign Exchange Transaction Regulation (FETR) has been amended to liberalize overseas investment in real property for non-residential purposes, effective from June 2, 2008.

According to the amended regulations, purchases of overseas real property for non-residential uses are liberalized although the overseas remittance for this purpose is still subject to notification to a foreign exchange bank. Previously, a reporting to the Bank of Korea was needed when any remittance in excess of US\$3 million is made to invest in real property overseas for non-residential uses.

Expansion of Ceiling on Joint Cash Management Overseas

The amended FETR also expands the ceiling on a pool of money that can be jointly managed by a multinational company from US\$10 million to US\$30 million.

Joint cash management system refers to a scheme whereby the head office and local subsidiaries of a multinational company sign an agreement to jointly manage corporate funds and freely borrow or lend the money among each other, not being subject to notification requirement to the foreign exchange authorities.

Rulings

Treatment of Considerations for the Use of Unregistered Patents

A recent ruling issued by the Ministry of Strategy and Finance provides that considerations paid to a US company by a domestic company for the use of a US patent not registered in Korea may not constitute royalties sourced in Korea as set forth under Article 6, Paragraph 3 and Article 14, Paragraph 4 of the Korea-US income tax treaty. The treaty states that a payment of any kind made as consideration for the use of patents shall be treated as income from sources within one of the contracting states only if it is paid in consideration for the use of the patent within that contracting state.

The ruling continues that if the subject knowledge, know-how or technology under the patent was provided by the US company to be used in Korea, considerations for the use of such knowledge, know-how or technology shall constitute a Korean-sourced royalty income. It shall be determined by the tax authorities whether the domestic company was provided by the US company with such knowledge, etc. based on the facts and circumstances including terms and conditions of the concerned contract (*Jaegukjo-66, 2008,5.16*).

Treatment of the Issuance of Exchangeable Bonds

A recent ruling refers to the tax treatment of the issuance of exchangeable bonds (XB) in a certain case. In the case, a local company intended to issue bonds exchangeable to the stocks of Company A to foreigners but for A's shares, foreign ownership is limited to 49%. In order to avoid potential future limitation on foreign ownership, the company transferred Company A shares to a special purpose company (SPC) established by a bond underwriter in a tax haven and the new SPC

issued bonds exchangeable with Company A's shares.

purpose of issuing XBs shall be treated as a share transfer rather than a borrowing for tax purposes (*Jaebeopin-3, 2008, 3.28*)

In the referred case, it was determined that the transfer of Company A shares to SPC for the

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
Shin-Jong Kang	82-2-709-0578	sjkang@samil.com
Sang-do Lee	82-2-709-0288	sdlee@samil.com