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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

### Special Withholding Tax Regime for Payment to Non-resident US Entertainment Companies

Under the special withholding tax regime, domestic companies must withhold income tax at 22% (including a 2% resident surtax) when making payments to non-resident US entertainment or sports management companies ("NESMC") in return for services performed through artistes, entertainers or sportsmen having contracts with the NESMC ("contract artistes"). When a NESMC makes any payment exceeding US\$3,000 to a contract artiste, the NESMC must withhold income tax on the payment at 22% and pay it to the Korean tax authorities no later than the tenth day of the following month after the actual payment to the individual. When the tax withheld by a domestic company exceeds the amount that NESMC is supposed to withhold, NESMC would be able to get a refund for the excess amount. Nonresident artistes and sportsmen having contracts with US companies may receive a foreign tax credit for the income tax withheld in Korea.

The special regime is applicable to payments made on or after January 1, 2008 if all of the following conditions are met:

- Services must be performed in Korea by a nonresident artiste having contract with NESMC;
- NESMC must receive a payment from a domestic company for services performed by its contract artiste; and
- NESMC must not have a permanent establishment (PE) in Korea or the Korean sourced income must not be attributable to any existing Korean PE of NESMC

According to the tax treaty, payments made by a domestic company to a US company for services rendered in Korea cannot be taxed in Korea unless the US company has a permanent establishment (PE) in Korea. But Korea has taxing rights on the income derived by a US individual resident for services rendered in Korea if such income exceeds US\$3,000 in a taxable year. The special withholding tax regime is intended to encourage foreign NESMCs to voluntarily comply with the Korean tax withholding obligation as otherwise, it is impossible for the Korean tax authorities to figure out when and how much the relevant individuals receive from their services in Korea.

## Recent Developments in Tax Policies

### Public Forum on the Proposed Consolidated Tax Return System

A public forum on the proposed consolidated tax return system was recently held by the Korea Institute of Certified Public Accountants (KICPA).

This was the first of its kind since the government revealed its plan to introduce the consolidated tax return system last March. Presently, Korea is employing the separate tax return filing system.

In the forum, the government's plan to implement the new system was presented and debated by academic, legal and tax professionals. According to the plan, the consolidated tax return is expected to be adopted in 2009, effective from 2010.

Provided below is a brief summary of major points of the proposed consolidated tax return system as discussed in the forum.

- The proposed system would be applicable to a parent corporation and its 100% subsidiaries.
- A taxpayer would be allowed to elect the current separate tax return filing system or the proposed new system, but cannot withdraw the election for at least five years.
- The business years of consolidated subsidiaries must be the same as that of the parent company
- Consolidated income would be the sum of taxable income of consolidated subsidiaries which are calculated after incomes or losses from intra-company transactions among consolidated entities are eliminated. Tax deductible limits for donations, entertainment expenses and DRD, etc. shall be recalculated.
- Consolidated taxable income would be the consolidated income less consolidated loss carried forward, non-taxable income and deductible income.
- The amount of corporate income tax would be calculated by applying the corporate income

tax rate to the consolidated taxable income

- The consolidated parent company would be liable for filing a tax return and paying the income tax due.
- Certain anti-tax avoidance measures, such as the limitation on deduction for loss incurred prior to the consolidation or built-in loss would be introduced.

### Latest Guide on NTS Tax Audit Procedures

The National Tax Service (NTS) has recently released its Audit Guide for 2008. The latest NTS Audit Guide ('the Guide') includes measures designed to enhance the transparency of target selection process and the taxpayer's convenience.

According to the Guide, criteria for selecting targets will be reviewed by the Target Selection Committee made up of government officials as well as external experts from the private sector.

Other major points of the Guide are summarized below:

- Taxpayer must be notified of an intended audit details including a subject tax issue, investigation period, duration, etc. at least 10 days before a field audit. Before a field audit, a taxpayer will be provided with a tax-audit orientation including the explanation of taxpayers' rights and details on audit procedures;
- A qualifying taxpayer may request a deferment of tax audit or a change in field audit site before a field audit as long as one of the prescribed conditions exists;
- If a field audit takes 20 days or more or there is an extension, the auditor must present the taxpayer a brief summary on the on-going investigation.
- Expansion of field audit coverage requires the pre-approval from the Taxpayer Protection Committee made up of representatives from the private sector and a written notification to the taxpayer with a reason and expanded

scope.

The Guide includes few changes in the post-audit procedures. When a field audit is closed, a pre-assessment notice is required to be issued to a taxpayer. If the notified pre-assessment is disputed, the taxpayer may file a request with the tax authorities to examine whether the pre-assessment is appropriate within 30 days from the date of receiving the pre-assessment notice.

After receiving the assessment, a taxpayer may file an appeal with the NTS, the Tax Tribunal or the Board of Audit and Inspection within 90 days from the date of receiving the official assessment notification.

### **EITC Payments Due and Requirements for Statement of Payments to Temporary Workers**

Beginning in 2008, Earned Income Tax Credit (EITC) is implemented to pay a cash refund to low-income workers

In order to verify the payments made to workers paid on a daily or hourly basis, the NTS has enforced the requirements that statements of payments made to daily or hourly-paid workers be submitted to the tax authorities on a quarterly basis. Non-compliance with the requirements is subject to 2% penalty (or 1% for late compliance with the requirements, i.e. submission within one month from the due date).

The payment statements must include details on salaries of workers paid on a daily or hourly basis who are employed by the same employer for no longer than three consecutive months (12 consecutive months in case of the construction industry).

Such details must be submitted to the concerned district office no later than the end of the month following the closing of each quarter. In other words, the statement for payments made during the 2<sup>nd</sup> quarter (from April to June) must be

submitted no later than 31 July.

### **Tax incentives for Foreign Investment in Bio Technology and Materials**

From July 2008, certain bio technology and materials will be added to the list of high technology industries where qualifying foreign investment receives tax exemption or reduction, according to the Ministry of Strategy and Finance.

Examples of tax-favored bio technology and materials include:

- Nano fiber and Nano complex fiber;
- Drillship product technology and winterization technology for polar resources exploration;
- PFC or SF6 collection and recycling alternative materials development and application technology;
- Substance of very high concern alternative materials or parts development services, chemical management services, bioequivalence test technology and etc.

For qualifying foreign investment in any of the prescribed high technology industries, the tax law presently provides 100% exemption for corporate or individual income tax as well as registration tax, acquisition tax and property taxes for the first five taxable years and 50% reduction for the following two years. Such a qualified foreign investment is also entitled to exemption on customs duties, special excise tax and value added tax on imported capital goods for the first three years.

## **Rulings**

### **Sales as a Basis to Calculate Entertainment Expense Deduction Limits**

According to Corporate Income Tax Law, entertainment expenses or common expenses incurred by a joint business shall be deductible within the limits as calculated in a prescribed formula. The amount of such expenses in excess

of the limits shall not be deductible.

A provision of the tax law stipulates that the calculation of deductible limits of those expenses must be based on the 'sales computed using the Korean financial reporting standards (Statements of Korea Accounting Standards, SKAS). In applying this provision, a question has been raised about the scope of the 'sales computed using the financial reporting standards.' In response to this query, a recent ruling provides that for the referred purpose, the base would be inclusive of the sales from discontinued business in addition to those from continuing operations, which are separately presented in the income statement. (Seomyon2 team-1304, 2008.6.25)

Effective from 2007, the Korean Accounting Institute has adopted the presentation of the

income statement in a way to separate the profits or losses from continuing operations and those from discontinued operations in consistent with the International Financial Reporting Standards.

Accordingly, an income statement is supposed to contain sales, cost of sales, gross profit (or loss), selling and administrative expenses, operating income (or loss), non-operating income, non-operating expense, profit or loss before income taxes from continuing operations, income tax expenses on profit or loss from continuing operations, profit or loss from continuing operations, profit or loss from discontinued operations (net of income tax), net income (or loss) and earnings per share.

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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