

Korean Tax Newsletter

August 2009



Proposed Revisions to Tax Laws

On 25 August 2009, the Ministry of Strategy and Finance (“MOSF”) announced a proposal for “Revisions to the Tax Laws in 2009,” which would make changes to the Corporate Income Tax Law, Tax Incentive Limitation Law, International Tax Coordination Law, Securities Transaction Tax Law, etc. The MOSF plans to submit the proposals to the National Assembly, and if approved, The measures will generally become effective as from 2010 .The main proposals include the following:

Tax Incentive Limitation Law

Tax credit for investment in energy saving facilities

Currently, where a company makes an investment in certain specified energy saving facilities, it can claim a tax credit of 20% of the investment amount. According to the proposal, Light Emitting Diodes (LED) illumination and plasma lighting would be added to the energy saving facilities eligible for the tax credit. In addition, a maximum tax credit cap would be introduced, so that the tax credit amount of a company could not exceed 30% of the income tax payable for the fiscal year and the sunset clause for this tax incentive would be extended to 31 December 2011.

Termination of temporary investment tax credit

According to the proposal, the sunset clause of the temporary investment tax credit (currently 3% or 10%) would not be extended, so that this credit will apply only up to the end of 2009.

Tax exemption on income from Islamic bonds (Sukuk)

Under current law, interest income from foreign currency denominated bonds received by a nonresident is exempt from withholding tax in Korea. According to the proposed revision, income from Sukuk which is, in substance, interest income but that takes a form of capital gains or rental income, etc. would be included in tax-exempt income if received by a nonresident.

Minimum tax rate for companies other than small and medium-sized companies (“SMC”)

The minimum tax rate for companies other than SMCs would be increased (in part) as follows:

Tax base (KRW)	Current		Proposed Revision	
	FY2009	FY 2010	FY2009	FY2010
10 billion or below	11%	10%	11%	10%
10 billion - 100 billion	11%	10%	14%	13%
Above 100 billion	14%	13%	14%	15%

The reduced minimum tax rates for SMCs would remain unchanged (i.e. 8% in FY2009 and 7% as from FY2010).

Tax credit for third party logistics expense

A company currently can claim a 3% tax credit (2.5% in FY 2010 and onwards) for third party logistics expenses exceeding 50% of the total logistics expenditure (“volume basis”) in the first year the company is eligible for the credit and at 3% (2.5% in FY 2010 and onwards) of incremental third party logistics expenditure (“incremental basis”) as from the second year if the following conditions are satisfied:

- the third party logistics expense ratio (i.e. third party logistics expense / total logistics expense incurred) in the fiscal year exceeds 50%; and
- the third party logistics expense ratio of the fiscal year is not less than that of the previous year.

Under the proposal, the calculation of the tax credit amount to be claimed in the first year would change from the volume basis to the incremental basis. However, a company whose third party logistics expense ratio in the previous year is less than 50%, but whose ratio in the fiscal year becomes 50% or more, would be entitled to the tax credit based on the volume basis. (It should be noted that the tax credit amount would be capped at 10% of the income tax payable for the fiscal year.)

Tax incentives for foreign engineers

Salary income received by certain foreign engineers in Korea currently is exempt from individual income tax for five years. The proposal would only allow a 50% exemption for two years and the sunset clause of this incentive would be extended to 31 December 2011.

Tax incentives for foreign employees

Under current law, foreign employees in Korea are eligible to opt for one of the following benefits: i) an income tax exemption equal to 30% of the total salary; or ii) the application of a flat tax rate of 15% (16.5%, including the 10% resident surtax). The proposal would abolish the 30% income exemption.

Extension of sunset clause

The proposed measures would extend the sunset clause of certain tax incentives to 31 December 2012:

- Tax credit for investment in R&D facilities;
- Tax exemption for newly incorporated SMCs; and
- Tax credit for investments of SMCs.

Corporate Income Tax Law

Tax incentives for various types of M&A transactions

The proposed measures would introduce various tax incentives (e.g. deferral of taxes on valuation gains, liquidation income and deemed dividend income of shareholders and exemption from Securities Transaction Tax) for certain M&A transactions where there is a qualified comprehensive stock exchange/transfer or comprehensive transfer of assets for stock. This new measure would be effective on or after 1 July 2010. However, details of requirements to qualify for the incentives have not been announced yet.

Deferral of tax on M&A valuation gains

Under the current Corporate Income Tax Law, the corporate income tax on merger/spin-off valuation gains derived by the upward valuation of transferred tangible fixed assets can be deferred until they are depreciated or otherwise disposed of provided certain conditions are satisfied. According to the proposals, the following requirements also would need to be met:

- Shareholders of a liquidating company would have to continue as shareholders of the surviving company for a certain period; and
- The surviving company would need to continue to have ownership of 50% or more of the assets transferred from the liquidating company for a certain period.

On the other hand, the scope of assets for which upward valuation gains may be deferred would be extended to all types of assets, including intangible fixed assets. This revision is proposed to be effective on or after 1 July 2010.

Deferral of tax on capital gains from in-kind contributions

Currently, where a company ("AA") establishes a new company ("BB") through an in-kind contribution of shares or tangible fixed assets, the corporate income tax on the capital gains derived by AA's contribution can be deferred until the shares are sold or otherwise disposed of. According to the proposed revision, where AA makes an in-kind contribution to another existing company ("CC") and receives shares newly issued by CC, the capital gains from AA's in-kind contribution also could be

deferred. Furthermore, the scope of assets eligible for capital gains deferral would be extended to include all types of assets.

This revision is proposed to be effective on or after 1 July 2010.

Conditions for indirect foreign tax credit

A Korean parent company can claim an indirect foreign tax credit on the underlying taxes of a qualified foreign subsidiary in proportion to the dividend amount received from the foreign subsidiary. To qualify under current law, a Korean parent company must hold at least 20% of voting rights of the foreign subsidiary for six months or more as of the dividend resolution date. The proposed revision would reduce the threshold ownership ratio from 20% to 10%.

Extension of due date for corporate income tax filing and payment

Domestic corporate taxpayers currently must file and pay their annual corporate income tax within three months after the fiscal year end. Under the proposals, a company subject to mandatory external audit under the Act on External Audit of Stock Companies (i.e. a company whose total asset amount as of the prior fiscal year end is KRW 10 billion or more, or which is listed on the Korea Exchange) could request to file and pay the corporate income tax within four months after the fiscal year end. However, interest at 0.03% per day would be imposed during the extended period.

International Tax Coordination Law

Foreign exchange rate in applying the thin capitalization rule

If a financial company (including a Korean branch of a foreign financial company) borrows funds from a foreign controlling shareholder ("FCS") or a third party with a guarantee from the FCS, and such borrowing exceeds 600% of its equity (or paid-in capital if that is greater than the equity) in the financial company, interest expense on the excess borrowing is not deductible. Under the current International Tax Coordination Law, the standard exchange rate as of the fiscal year end is applied when calculating the accumulated balance of the borrowing from a FCS or a third party with a guarantee from the FCS. The proposed revision would give taxpayers an option to use one of the following exchange rates: 1) the standard exchange rate as of the fiscal year end; or 2) the daily exchange rate after the borrowing date to the fiscal year end. In addition, once the taxpayer opted for a foreign exchange rate, it would have to be applied for five years.

This proposed revision would take effect as from FY2009.

Controlled foreign corporation rules for foreign holding company subsidiary

The International Tax Coordination Law currently provides that if a foreign holding company subsidiary holds 50% or more in a controlled foreign company (CFC) (shareholding ratio requirements) that is located in the same country or region (location requirements), and 90% or more of the passive income of the foreign holding company subsidiary is comprised of dividends and interest received

from CFCs, it is not subject to the CFC rules. Under the CFC rules, reserved income of a CFC is deemed to be distributed as dividend income to the domestic parent company. The proposed revision would lower the shareholding ratio requirements of the foreign holding company subsidiary from 50% to 40%.

Securities Transaction Tax Law

Beneficiary certificates of Exchange Traded Fund

Securities transaction tax is currently levied at a rate of 0.3% (including surtax) on the transfer of stock or an equity interest on the Korea Exchange. It is proposed that the securities transaction tax rate for beneficiaries of Exchange Traded Funds, which are listed and traded on the Korea Exchange, would be 0.1%.

If you have any questions concerning the items in this month's newsletter, please contact your tax advisor at Deloitte Anjin LLC or the following tax professionals:

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