



Newsletter

October 2007

This newsletter is prepared by Horwath Choongjung (Choongjung Accounting Corp.) and intended to provide foreign investors with an update on tax law changes in Korea and other related subjects of special interests to foreign investors. The information provided herein should not form a basis of any decision as to a particular course of action, nor should it be relied upon as a substitute for a detailed advice in individual cases.

Topics covered in this edition of Newsletter include

- ◆ **Horwath Choongjung News**
 - ▶ Won A Strategic Planning Project for Korea Electric Power Corporation (KEPCO)
 - ▶ Selected as Consultation Service Provider for Investment Plan and Business Feasibility Review for Gyeonggi Province
 - ▶ Appointed as Non-government Delegate of Investment Pool Operating Committee
- ◆ **Proposed Tax Law Changes**
 - ▶ Amendment of Tax Brackets for Individual Taxpayer
 - ▶ Introduction of Income Deduction related to Mandatory Insurance Premium for Long-term Medical Care of the Senior Citizen
 - ▶ Assessment of Heavy Penalty on Recipient of Fictitious VAT Invoice
 - ▶ Introduction of Partnership Taxation from 2009
 - ▶ Clarification of Substance over Form Principle
- ◆ **Bilateral Tax Treaty Development**
 - ▶ Brazil / Korea Tax Treaty: Retroactive Application of Reduced Withholding Tax Rates
 - ▶ Kazakhstan / Korea Tax Treaty: Retroactive Application of Reduced Withholding Tax Rate
- ◆ **New Tax Rulings**
 - ▶ Ineligibility of Zero-rate VAT in case of Receipt of Consideration from Non-resident Free Won Account
 - ▶ Taxation on Foreign (Non-Korean) Officer's Gain from Stock Option Exercise after Termination
 - ▶ Taxation on Settlement Fee for Infringement of Software Rights
 - ▶ Income Classification of Sale of Stock under Put Option Contract
- ◆ **Labour Law Changes**
 - ▶ Major Changes from July 2007

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(You may find this newsletter and other items of interest at <http://www.horwath.co.kr>)

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Horwath Choongjung News

Newsletter October 2007

Won A Strategic Planning Project for Korea Electric Power Corporation (KEPCO)

Horwath Choongjung Consulting Corp. (“HCCC”) won a strategic consultation project from KEPCO for “performance analysis of the power plants before and after the split and their efficiency improvement strategy”, which was a well-known hot issue throughout the consulting industry.

Many of the interested parties showed their concerns and interests on this project due to the importance of the electric power industry restructuring in Korea, and therefore it was unavoidable to have a stiff competition with the big global consulting firms such as PwC, Deloitte, Accenture, and ADL.

HCCC will closely monitor performances of the power plants (one hydro power plant and five steam power plants) after the split from KEPCO and provide econometric models to measure and evaluate their performances more accurately, and based on the performance evaluation, HCCC will then present efficiency improvement strategies for these power plants. The report on this project will be confirmed and finalized after going through public hearings of various parties of interests.

Selected as Consultation Service Provider for Investment Plan and Business Feasibility Review for Gyeonggi Province

Horwath Choongjung Accounting Corp. (“HCAC”) has built up a positive collaboration with Gyeonggi Province by entering into an agreement for support of management affairs of foreign invested companies, relating to investment inducement of foreign invested companies in Gyeonggi Province. Additionally, HCAC will provide the consultation services to foreign invested companies for investment inducement for a theme-park by establishing an advisory contract with Gyeonggi Province on July 18, 2007.

The HTL (Hotel & Tourism, Leisure) service unit of Horwath Choongjung is confident to make a fair evaluation about the investment proposals and the business plans based on the know-how we have built up from experiences in the HTL industry to date.

Horwath Choongjung News, *Continued*

Newsletter October 2007

**Appointed as Non-government
Delegate of Investment Pool
Operating Committee**

Mr. H J Hwang, Managing Partner of HCAC, was appointed as one of the nongovernmental delegates for the “Investment Pool Operating Committee” of the Ministry of Planning & Budget on August 31, 2007. The Committee is an organization for final decision-making on the operation of the investment pool consisted of available funds sourced from various statutory governmental funds.

Proposed Tax Law Changes

Newsletter October 2007

We summarized below some of the major proposed tax law changes to keep you up to date. Most of the proposed tax law changes we discuss below may come into force effective from the fiscal year starting (or for payments/investments made or income earned) on or after January 1, 2008 unless indicated otherwise (please note that the tax rates provided below are exclusive of the resident surtax).

1. Amendment of Tax Brackets for Individual Taxpayer

According to the proposed Individual Income Tax Law of Korea (“IITL”), the tax brackets for the global income have been amended in order to relieve an individual taxpayer’s tax burden as shown in the following table.

Current		Proposed	
Tax base	Tax rate	Tax base	Tax rate
Up to W 10,000,000	8%	Up to W 12,000,000	8%
Over W10,000,000 ~ Up to W 40,000,000	17%	Over W 12,000,000 ~ Up to W 46,000,000	17%
Over W 40,000,000 ~ Up to W 80,000,000	26%	Over W 46,000,000 ~ Up to W 88,000,000	26%
Over W 80,000,000	35%	Over W 88,000,000	35%

2. Introduction of Income Deduction related to Mandatory Insurance Premium for Long-term Medical Care of the Senior Citizen

As the ‘Act for Long-term Medical Care of the Senior Citizen’ is scheduled to be implemented from July 1, 2008, a new item of income deduction for the insurance premium would be introduced according to the proposed IITL for the payment made on or after July 1, 2008.

Under the ‘Act for Long-term Medical Care of the Senior Citizen’, an employer and an employee each must contribute 0.2% of the employee’s monthly salary, total being 0.4%, to the program.

An employee may claim income deduction when filing income tax return through its employer for the contribution he/she makes.

Proposed Tax Law Changes, *Continued*

Newsletter October 2007

3. **Assessment of Heavy Penalty on Recipient of Fictitious VAT Invoice**

Under the proposed Value Added Tax (“VAT”) Law, a recipient of fictitious VAT invoices may be imposed a penalty tax at 2% of the transaction amount as well.

Currently, only an issuer of fictitious VAT invoices is imposed a penalty tax at 2% under the VAT Law.

4. **Introduction of Partnership Taxation**

A partnership taxation scheme was introduced in the proposal for the tax law change, under which a certain type of entity (defined) could be treated as a pass-through entity and may not be taxed on its taxable income at the entity level. Instead, the income would be taxed at the partner level for its share of the income.

This scheme may become effective from the fiscal year starting January 1, 2009.

5. **Clarification of Substance over Form Principle**

According to the proposed National Tax Basic Law, if the indirect transactions with a specially related party through third parties or a series of the transactions are regarded as unfairly reducing tax burden of a taxpayer, such transactions would be treated as the direct transactions or a single transaction under the substance over form principle.

Bilateral Tax Treaty Development

Newsletter October 2007

1. **Brazil / Korea Tax Treaty: Retroactive Application of Reduced Withholding Tax Rates**

According to Article 3 of the protocol of the Brazil / Korea Tax Treaty, in the case where Brazil later enters into a tax treaty with the other country (except for the countries in Latin America) at a lower reduced withholding tax rates on dividend and royalty income, the reduced withholding tax rate on the foregoing income (stipulated in Article 10 and Article 12 of the Brazil / Korea Tax Treaty) shall be further reduced to the same rates.

Due to the effectuations of the Brazil / Finland Tax Treaty and the Brazil/Israel Tax Treaty, the reduced withholding tax rates of dividend and royalty for the copyrights (being paid on or after January 1, 1998) and other royalty income (being paid on or after January 1, 2006) were revised to 10% from 15% retroactively whereas the rate on consideration for the trademarks remains unchanged as 25%.

2. **Kazakhstan / Korea Tax Treaty: Retroactive Application of Reduced Withholding Tax Rates**

According to Article 3 of the protocol of the Kazakhstan / Korea Tax Treaty, a reduced withholding tax rate on consideration for the use of, or for the right to use of, the industrial, commercial or scientific equipments (stipulated in Article 12 of the tax treaty) shall be further reduced to the same rates of the tax treaty, in the case where either country later enters into a tax treaty with other OECD member countries at a lower reduced withholding tax rates on the foregoing income.

Due to the effectuation of the Germany / Korea Tax Treaty, a reduced withholding tax rate on consideration for the use of, or for the right to use of, the industrial, commercial or scientific equipments were revised from 10% to 2% for payments on or after January 1, 2003 retroactively.

New Tax Rulings

Newsletter October 2007

1. **Ineligibility of Zero-rate VAT in case of Receipt of Consideration from Non-resident Free Won Account**

In the case where a taxpayer receives consideration in Won for its business services provided to a foreign(non-Korean) company, who does not have its permanent establishment in Korea, from a non-resident free Won account of the foreign company, such service provision shall not be eligible for the zero VAT rate under Article 26, Paragraph 1(1) of the VAT Law of Korea (Seomyon 3 team – 2386, 2007.08.24).

2. **Taxation on Foreign (Non-Korean) Officer's Gain from Stock Option Exercise after Termination**

In the case where a foreign officer was granted stock options by the Korean company while working in Korea and exercises them in a non-resident status after his termination, the Korean company who pays such exercise gains shall withhold income taxes and make an year end settlement thereon. With regard to this income, the foreign officer may elect to be taxed at a flat rate of 18.7% (including resident surtax) by submitting the application of flat rate taxation eligible for foreign employee at year-end settlement or global income tax return filing (Seomyon 2 team – 1582, 2007.08.29).

3. **Taxation on Settlement Fee for Infringement of Software Rights**

In the case where a Singaporean company, which does not have a permanent establishment in Korea, receives from a Korean company settlement fees for infringement of its software rights, on the condition that the Singaporean company withdraws the lawsuit against the Korean company, such fee shall be considered as royalty income under Article 93-9 of the Corporation Tax Law of Korea and under Article 12 of the Singapore / Korea Tax Treaty (Seomyon 2 team – 1551, 2007.08.24).

4. **Income Classification of Sale of Stock under Put Option Contract**

In the case where a resident taxpayer enters into an apparent contract of share transfer with a foreign investor but has a put option that the foreign investor can sell the shares back to the original seller at the original transfer price plus certain interest, such capital gains shall be regarded as interest income if they are substantially considered as interest income, according to Article 4 (Substance over Form Principle) of the Corporation Tax Law, etc. (Seomyon 2 team – 1785, 2007.10.05).

Labor Law Changes

Newsletter October 2007

We summarize below some of the major changes on the Labor Standards Act that have become effective from July 2007 as follows.

1. Clarification of Working Conditions in “Labor Contract”

Under Article 17 (Statement of working conditions) of the revised Labor Standard Act of Korea (“LSA”), working hours, holidays, and annual paid leaves shall be clearly stated in the employment contract in addition to wage that is required by the existing law. This law has been revised in order to avoid any dispute that may arise due to ambiguous contract conditions. An employer shall be fined at Won 5 million upon violation of this LSA.

2. Reduction of Prior Notice Period to 50 Days for Dismissal(Retrenchment) for Managerial Reasons

The prior notice period for dismissal for managerial reasons has shortened by 10 days from 60 days to 50 days due to the inefficiency of long process period under Article 24-3 of the revised LSA. In order for an employer to dismiss a worker for managerial reasons, there must be i) an urgent managerial need, ii) the effort to avoid dismissal of workers, and iii) a rational and fair standard of dismissal established.

3. Written Notice of Dismissal

Article 27 (Written notice of dismissal) of the LSA has been newly enacted, under which an employer shall give an advance written notice of dismissal to an employee concerned, which includes a reason for dismissal and an exact termination date. The current LSA before change does not have a clear-cut provision for this written notice requirement for dismissal. Without a written notice, the dismissal of workers shall be invalid.

4. Change in Penal Clause related to Unlawful Dismissal of Employee

Under the revised LSA, in case of an unlawful dismissal of employee, an employer shall be imposed the enforcement penalty enacted from July 1, 2007. The penal clause for dismissal without cause (i.e., being punished by imprisonment for not exceeding five years or by a fine not exceeding Won 30 million) was eliminated.