

Doing Business in Korea

2010



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1. Introduction

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in over 70 countries throughout the world. Business partners work together through the network to conduct trans-national operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Korea has been provided by the office of UHY representatives:

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Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and take professional advice before making any decisions. This publication is current at February 2010.

We look forward to helping you do business in Korea.

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2. Business environment

Korea's gross domestic product (GDP) in 2008 decreased to US\$928 billion from US\$1050 billion in 2007, mainly due to lower facilities and construction investment and a sharp slowdown in private consumption and exports. However, Korea's economy recently expanded at its fastest pace in more than five years boosted by government stimulus measures and a sharp rebound in exports. According to the Bank of Korea (BOK), real GDP grew 2.3% in the second quarter from the first quarter, when the economy edged up 0.1% from a quarter earlier. It was the largest expansion since growing 2.6% in the fourth quarter of 2003. Korea was the 15th largest economy in the world at the end of 2008, with a per capita income of US\$ 19,231.

At US\$14,441.4 billion, the United States recorded the world's largest GDP in 2008, followed by Japan (US\$4,910.7 bil.) and China (US\$4,327.4 bil.). The Korea's yearly economic growth rate in 2008 was 2.2% comparing with those of the developed countries; for example, the United States (0.4 percent), Japan (-0.7 percent), China (9 percent), Britain (0.7 percent) and Germany (1.3 percent).

Balance of payment

Korea had a current account deficit of US\$6.4 billion in 2008. The deficit was a sharp decrease from the previous year recording US\$6 billion of current account surplus. The details of the current account deficit by sectors are as follows. The goods account recorded a surplus of US\$6 billion in 2008, a decrease of US\$22 billion compared to US\$28.2 billion in 2007. The service account deficit reduced from US\$19.8 billion to US\$16.7 billion. The surplus in the income balance had increased from US\$1 billion to US\$5.1 billion for the same period.

Balance of payment by year

(Unit: US\$1 bil.)

	2004	2005	2006	2007	2008
Current Account	28.1	15	5.4	5.9	-6.4
Goods Account	37.6	32.7	27.9	28.2	6
Services Account	-8	-13.7	-19	-20	-17
Income Account	1.1	-1.6	0.5	1	5.1
Current Transfers	-2.4	-2.5	-4.1	-3.5	-0.8
Capital Account	7.6	4.8	18	7.1	-51

Source : Bank of Korea

The followings are the current account surpluses(deficits) of world major economies in 2008.

Employment

Departing from the denting aftermath of the currency crisis in 1997, when corporate bankruptcies and restructuring resulted in the unemployment rate skyrocketing to 7 percent, Korean labour market has been stabilized with the figure staying around 3.5 percent over the last four years.

Unemployment Situation

(Unit: million persons, %)

	2004	2005	2006	2007	2008
Employed	22.56	22.86	23.15	23.43	23.58
Unemployed	0.86	0.89	0.83	0.78	0.77
Unemployment Rate	3.7	3.7	3.5	3.2	3.2

Source : The Bank of Korea.

Significant reforms to improve the flexibility of the employment market have also contributed to employment stability. Part-time and contract employment have increased while permanent/ full-time employment has decreased, weakening the strength of labour unions but increasing labour flexibility. As corporate earnings are recovering, the employment market, which suffered severe unemployment, is gradually recovering and regaining its vitality as well.

In response to the rapidly changing economic environment and labour market conditions, the government has since July 2004 been successively putting into effect the 40-hour work week to reduce the legal work hours. This move aims to create new jobs, raise labour productivity and increase general standards of living.

Inflation

The consumer price index has risen by a yearly average of 3.16 percent over the past five years from 2004 to 2008, while it recorded 4.7% in 2008, a comparatively high growth rate against other major world economies.

Price Trends

(Unit : %)

2004	2005	2006	2007	2008
3.6	2.8	2.2	2.5	4.7

Source: Bank of Korea

2008 Consumer Price Indices of 6 Economies

(Unit : %)

U.S.A.	U.K.	Germany	Euro zone	Taiwan	Japan
3.9	3.6	2.6	3.3	3.5	1.4

Source: The Bank of Korea

This was attributed to the fact that the continued price increases of international raw material, including crude oil, are causing recent price instability and the pressure of cost-increase type inflation with foreign factors is getting higher.

To cope with this situation, the government and the Bank of Korea are making great efforts to control possible inflation by exercising flexible monetary policies.

3. Foreign investment

Foreign Direct Investment (FDI)

Acquisition of Stocks or Equity of Domestic Companies

(Article 2.1.4.1 of the Foreign Investment Promotion Act, FIPA)

Acquisition by foreign nationals of shares or equity of (1) a Korean corporation; or of (2) a company runs by a Korean national for the purpose of establishing the lasting economic relations by participating in the management of such a corporation or company;

- The amount of foreign direct investment shall be KRW50 million. If two or more foreign nationals make a joint investment, each has to make an investment of at least KRW50 million (Article 2.2 of FIPA);
- Where foreign nationals own 10% or more of the total voting stocks issued by (1) or (2) above; or 10% of the total amount of capital contribution of (1) or (2) above (Article 2.2.1 of the Enforcement Decree);
- Where foreign nationals own less than 10% of the total voting stocks issued by (1) or (2) above; or less than 10% of the total amount of capital contribution of (1) or (2) above, and where they enter into the following agreements:
 - a) Agreements concerning officer's dispatch or appointment; ("Officers" refer to those who are entitled to take part in important managerial decision-making processes as director, representative, partner with unlimited liability, or equivalent)
 - b) Agreements concerning the provision or introduction of technology or joint research/ development projects;
 - c) Agreements concerning the supply and purchase of products/raw materials for more than one year.

Long-Term Loans (FIPA, Article 2.1.4.2)

Where loans with maturity of five years or longer are granted to foreign-invested companies (hereinafter FDI companies) by their overseas parent companies or by companies which have capital affiliation with the parent companies (Article 2.3 of the FIPA Enforcement Decree).

Companies which have capital affiliation with the parent companies which means:

- Companies which own 50% or more of the total issued stocks or of the total amount of capital contribution of the overseas parent

- companies;
- Companies which fall under the following categories, provided that the overseas parent companies of the FDI companies own 50% or more of the total issued stocks or of the total amount of capital contribution of the said FDI companies:
 - Companies which own 10% or more of the total issued stocks or of the total amount of capital contribution of the overseas parent companies;
 - Companies of which 50% or more of the total issued stocks or of the total amount of capital contribution are owned by the overseas parent companies or companies with more than 50% of the total shares or of the total amount of capital contribution of the overseas parent companies.

Foreign Investors and the Object of Investment

Foreign Nationals (FIPA, Article 2.1.1)

- Individuals possessing foreign nationality;
- Foreign companies established under the laws of foreign countries;
- Organizations for international economic cooperation:
 - Agencies engaging in international economic cooperation for the governments of foreign countries
 - Organizations or agencies which provide development financing services, such as the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC), the Asian Development Bank (ADB), etc.

Foreign Investors (Article 2.1.5 of FIPA)

Foreign nationals who own stocks or equity pursuant to FIPA

FDI Companies (Article 2.1.6 of FIPA)

Companies in which foreign investors have invested capital.

Operators of Facilities for the Promotion of the Foreign Investment Environment (Article 2.1.6.2 of FIPA)

- Operators of the following facilities providing schools or medical facilities for foreigners designed to improve the foreign investment environment:
 - Foreign schools (Article 60.2 of Elementary Education Law);
 - General hospitals, hospitals, dental hospitals, oriental hospitals, nursing-homes, clinics, dental clinics, oriental clinics and maternity hospitals (Article 3.2 of Medical Law)
 - Pharmacies (Article 2.3 of Pharmacist Law)

- Housing (Article 2.1 of Housing Law)
- Other facilities, including business incubators, which are reviewed by the Foreign Investment Committee and notified by the Minister of Commerce, Industry and Energy.

Object of Investment (Articles 2.1.7 and 2.1.8 of FIPA)

Means of investment contributed by foreign nationals for the purpose of acquiring stocks:

- International means of payment under the Foreign Exchange Transactions Act, or domestic means of payment arising from the exchange thereof (i.e., foreign currency);
- Capital goods:
 - Machinery, equipment, facilities, apparatus, components, and parts treated as industrial facilities including ships, motor vehicles, airplanes, etc.; livestock, seeds, plants, trees, fish and shellfish necessary for the development of agriculture, forestry and fisheries;
 - Raw materials and spare parts for the test operation of facilities deemed necessary by the competent ministers; freight and insurance premium costs for the transportation of such materials; technology utilized in the installation of related facilities; or services engaging in consultation with respect to the import of such materials.
- Income generated from stocks or equity acquired pursuant to FIPA (dividends);
- Industrial property/intellectual property rights and other equivalent rights dealing with technology and the use thereof:
 - Intellectual property rights: Rights utilized for industrial activities among the copyrights under the Copyright Act and layout design rights in Article 2.5 of the Layout Designs of the Semiconductor Integrated Circuit Act.
- Remaining assets generated from the liquidation of a foreign company's branch or liaison office located in Korea;
- Repayment of long-term loans with maturity of five years or longer, pursuant to FIPA, to FDI companies by their overseas parent companies and to companies affiliated with the respective overseas parent companies;
- Stocks of a foreign company listed on a foreign stock exchange market;
- Stocks owned by foreign nationals pursuant to the Foreign Exchange Transactions Act;
- Real estate in Korea owned by foreign nationals;
- Other domestic means of payment: Sales proceeds from the disposition of real estate and stocks of a Korean company owned

by foreign nationals pursuant to FIPA and the Foreign Exchange Transactions Act.

FDI Amount and Ratio

- The amount of FDI shall be at least KRW50 million per case. In the case of stock acquisition, the total cost shall be at least KRW50 million. Also, if there are two or more foreign investors, the minimum investment amount shall be KRW50 million for each investor (Article 2.2 of the Enforcement Decree).
- In principle, the FDI ratio shall be 10% or more, meaning that foreign investors shall acquire 10% or more of the stocks of a company. However, where foreign investors have entered into the following contractual agreements, an FDI ratio of less than 10% is allowed (Article 2.2.2 of the Enforcement Decree).
 - Agreements concerning the dispatch or appointment of officers (director, representative director, partner with unlimited liability, auditor, or equivalent who are entitled to participate in critical decision-making processes);
 - Agreements concerning the supply and purchase of products/raw materials for more than one year;
 - Agreements concerning the introduction or provision of technology, and joint research and development projects.

4. Setting up a Business

Foreigners may establish a domestic business presence in the following four ways: through establishment of a local corporation or a sole proprietorship, to either of which the Foreign Investment Promotion Act ("FIPA") is applicable, or through establishment of a branch or an office under the procedures as set forth in the Foreign Exchange Transactions Act ("FETA"). A foreign corporation, however, may not be registered as a domestic sole proprietorship.

Local Corporation

The provisions of the FIPA and the Commercial Law are applicable to foreign investment through establishment of a local corporation by a foreigner or a foreign company. A local corporation is treated equally as a domestic corporation. Establishment of a local corporation requires a foreigner to invest 50 million won or more, whereas such minimum capital requirement is not applicable in the case of a branch or a liaison office.

Sole Proprietorship

Investment in the form of sole proprietorship is classified as direct foreign investment as well if the amount of the investment is 50 million won or more. The sole proprietorship is not a legal entity apart from its owner, i.e. the proprietor is subject to unlimited personal liability for claims against the business. The proprietor himself is subject to taxation. This form of business organization is commonly used for small enterprises and operations.

Branch

Conduct by a foreign company of ordinary business activities in Korea requires appointment of a representative of a domestic branch, undertaking procedures to establish a branch under the FETA and registration with the court. In addition, a branch is classified as a permanent establishment of business under tax law. To the income generated from the domestic business, the same corporate income tax rate is applicable as to those from domestic corporations.

Liaison Office

A liaison office is allowed to perform non-business activities only while a branch may conduct business activities. Accordingly, a liaison office requires a serial number issued by the competent tax office similar to that in business registration, but no registration with the court.

5. Labour

Labour Laws

Labour laws serve to provide protection for workers, thereby enhancing the stability of the economy. There are several categories of labour laws in Korea: the individual labour relations laws, the collective industrial relations laws, the cooperative industrial relations laws, and the employment laws.

Individual Labour Relations Laws

The individual labour relations laws define the relationship between individual employees and their employers. In other words, they provide legal criteria pertaining to a contract of employment between an employer and his (her) employee, the contents of the employment relationship, and the procedural relationship, thus protecting working conditions for individual employees.

This category of labour law includes: the Labour Standards Act, Act concerning Protection, etc. of Fixed-term and Part-time Workers, Act Relating to Protection, etc. of Dispatched Workers, the Minimum Wage Act, the Industrial Accident Compensation Insurance Act, the Equal Employment Act and the Employee Retirement Pay Guarantee Act.

Collective Industrial Relations Laws

The Collective industrial relations laws govern labour relations between worker organizations, such as trade unions and employee representatives, and employers. These laws are intended to establish an autonomous problem-solving practice (labour-management autonomy), by guaranteeing the right to organize for workers who are underprivileged in social and economic terms, compared to their employers so that the former may be on an equal footing with the latter.

This category of labour law includes: the Trade Union and Labour Relations Adjustment Act; the Labour Relations Commission Act; the Act concerning Establishment and Operation of Teachers' Unions; and the Act concerning Establishment and Operation Public Servants' Unions.

Cooperative Industrial Relations Laws

The cooperative industrial relations laws are aimed at realizing sustained development for enterprises, industrial peace and a continuous growth in the national economy, by promoting cooperation and participation of employers and employees and pursuing their co-prosperity.

This category of labour includes the Act concerning Promotion of Worker Participation and Cooperation, which was enacted on March 13 1997 to promote cooperation in labour relations.

Employment-Related Laws

This category of labour law, which includes the Basic Employment Policy Act; the Vocational Security Act; the Act Relating to Protection, etc. for Dispatched Workers; the Employment Insurance Act; the Act on Employment Promotion and Vocational Rehabilitation for Disable; the Aged Employment Promotion Act; the Workers' Vocational Ability Development Act; and the Act concerning Employment, etc of Foreign Workers, is intended to contribute to a stable life for workers and to further development of the national economy, by balancing the labour supply and demand in the labour market and promoting employment security.

Retirement

Each and workers should choose either retirement pay or retirement pension, in order to pay retirement benefit to retiring employees.

Retirement pay: When an employee has worked for 1 year or longer consecutively for an employer, the employer shall give the employee retirement pay equivalent to at least 30 days' average wage per each year worked.

Retirement insurance: When an employer chooses to contribute to a retirement insurance fund or another equivalent insurance program, it shall be deemed that the employer has adopted a retirement pay scheme. It should be noted, however, that retirement insurance is valid until December 31, 2010.

Retirement pension: There are two different models of retirement pension; defined benefit (DB) and defined contribution (DC), and each and every workplace should adopt either of the two.

Social insurance

1. National pension (against invalidity, death and old-age life)
2. Health insurance (against non-occupational illness and injury)
3. Industrial accident compensation insurance (against occupational disease and injury)
4. Employment Insurance (against joblessness).

Employers are obligated to provide National pension, Health insurance, Industrial accident compensation insurance, and Employment insurance. The premiums assumed by the employers in proportions to the cost of labour are as follows:

	Total	Assumed by the Employees	Assumed by the Employers
National pension	9%	4.5%	4.5%
Health insurance	5.08%	2.54%	2.54%
Long-term care insurance (proportion to health insurance)	9.56%	4.78%	4.78%
Industrial accident compensation insurance	1.7%	None	1.7%
Employment insurance	1.15%~1.75%	0.45%	0.7%~1.3%

6. Taxation

The taxation of commercial activity in Korea depends on the particular form of business organization chosen. The main aspect to be considered in this context is that the income and net worth of unincorporated companies are taxed at the level of the individual partner, while a corporation represents an independently taxable entity.

English Web Page of NTS: <http://www.nts.go.kr/eng>

Foreign Taxpayer Help-line (English): 02-397-1440

Unincorporated Companies and Individuals

Taxpayer

Taxpayer, who is liable to pay the income tax on his/her income, is classified into Resident and Non-resident in terms of whether a country has the taxing right on his/her worldwide or just domestic income, and the scope of income deduction pursuant to the provisions of Income Tax Act of Korea.

Resident

Principally, a resident is any individual who has his/her domicile in Korea or a place of residence for 1 year or more in Korea. The domicile shall be judged by the objective facts of living relationship, such as the existence of a family living together in Korea and of the property located in Korea. And, the 'place of residence' means the place where a person has dwelt for a long time besides his address.

A taxpayer who falls under the following cases is deemed to have a domicile in Korea.

- Who has an occupation which would require him/her to live in Korea for 1 year or more; or
- Who has his/her family in Korea and is likely to reside in Korea for 1 year or more in view of his/her occupation or assets held in Korea.

A resident is subject to income tax on all incomes derived from sources both within and outside the country.

Non-Resident

Any individual other than a resident is a non-resident, who is liable to income tax only on the income derived from sources within Korea.

Taxable Income

As stated above, resident individuals are taxed on their worldwide income. Non-resident individuals are taxed only on Korean-source income. Regarding taxation method, income derived by residents and non-residents is subject to global and schedular taxation. Under global taxation, interest, dividend, real estate rental income, business income, wages and salaries, pension income, and other income are aggregated and taxed progressively. Under separate taxation, however, capital gains and retirement income are taxed separately at varying tax rates.

Global income

Global income is the income which is subject to global taxation and includes interest, dividend (including deemed dividend), real estate rental income, business income, wage and salary, pension income and other income.

Taxable income comprises the entire annual income from the following source:

- interest, dividends, real estate rental income
- business income, wage and salary income
- pension income, other income.

Non-Global income (Classified income)

Non-global income denotes the income which is separately taxed from the global income at varying rates. It includes Retirement income, Capital gains.

Tax rates

Tax Base of Global Income	Tax Rates
12 million Won or less	8%
12- 46 million Won or less	0.96 million won + 17% of the amount exceeding 12 million Won
46- 88 million Won or less	6.74 million won + 26% of the amount exceeding 46 million Won
over 80 million Won	17.66 million won + 35% of the amount exceeding 88 million Won

The additional local tax (Inhabitant surtax) is 10 percent of the income tax.

Exemptions and credits

Tax exemptions

A foreigner may choose separate taxation of total income from employment by multiplying such income by 15/100 instead of Tax rate of Individual Income Tax, Art.55-1. In this case, provisions concerning such tax exemption, deduction, reduction, and tax credit shall not be applicable. (RSTA (Restriction of Special Taxation Act), Art. 18-2).

Wages received by the person working in a foreign government or an international organization(the United Nations and its affiliated organs) as prescribed by §14 of the Enforcement Decree of the Income Tax Act ; in case of a foreign government, the principle of reciprocity is applied.

Wages derived from the provision of his services to a national within Korea if such employment income has been earned until the month whereto belongs the date on which 5 years have passed since the first date on which the foreign engineer provided his services in Korea.(RSTA, Art. 18)

Wages derived by providing his services to a national within Korea under a contract for the introduction of technologies as referred to in the Foreign Investment Promotion Act. In this case the exemption amount shall be limited to the income earned until the month whereto belongs the date on which 5 years have passed since the date of delivery of the certificate of report on a contract for the introduction of such technologies. (RSTA, Art. 18)

Tax credits

Class B income earner may either join a Taxpayers' Association to pay monthly taxes, thereby enjoying 10% tax credit, or may wait and file an annual tax return by the end of May of the following year with no benefit of credit. If a branch in Korea of a foreign corporation claims as a deductible expense an expatriate's salary paid outside Korea, the salary is deemed to be class A income and the branch must withhold income tax on the monthly salary.

Corporations

Companies subject to corporation tax in Korea can be classified into two types: domestic or foreign and for profit or non profit. For tax purposes, a company with its head or main office in Korea is deemed to be a domestic company and is liable to tax on its worldwide income. Otherwise, it is considered to be a foreign company, and the tax liability of foreign companies is limited to Korean-source income.

Taxpayer

Domestic Corporation

1. A corporation with its head or main office in Korea is liable to corporation tax on its worldwide income
2. A for-profit domestic corporation is liable to tax on the following items of income.
 - All items of ordinary business income including income from sales of real estate property
 - Liquidation income : income realized upon liquidation of the business due to a corporate merger, a consolidation, or a cessation of the company as a taxable entity
3. For non-profit domestic corporation, the following items of income are taxable :
 - income from profit-making business under the Korean Standard Industrial Classification
 - interest income and discount from deposits and debenture(including public bonds)
 - dividend and distribution of profit companies,
 - capital gains from the alienation of stocks, preemptive rights, or shares
 - capital gains from the alienation of fixed assets not used directly for non-profit corporations
 - gains for the transfer of bonds and debentures.

Foreign Corporation

When a corporation with its head or main office located in a foreign country earns income from domestic sources, only the income from a domestic source is subject to corporation tax; however, income from the liquidation of a foreign corporation is not taxable.

For non-profit foreign corporations, no corporation tax is assessed on income other than that from profit making businesses in Korea.

Rules and Special Cases Determining Liability

When a corporation to which the corporation income is legally attributed is different from the corporation to which the said income actually belongs, the corporation tax shall be assessed on the corporation to which the said income actually belongs.

For income attributable to a trust estate, the beneficiary of the trust is subject to corporation tax.

Taxable and Non-Taxable Income

Taxable Income

The corporation tax is assessed on the following income:

- income during each business year
- liquidation income (non-profit domestic and foreign corporations are exempted).

Non-taxable income

Corporation tax is not levied on income derived from property of public welfare trusts: it does not matter whether the application for non-taxation is submitted or not.

Tax base

The income of a domestic corporation during each business year is the amount remaining after deducting the gross amount of losses from the gross amount of gains in the same business year.

Tax rates and Credits

Tax Rates

Not over 200 million won	10% of tax base
Over 200 million won	20 million won + 22% of (tax base-200million)

The additional local tax is 10 percent of the corporation tax.

Tax rates effective from Jan.1.2010.

Tax Credits

Credit for tax abroad

Where a domestic corporation has paid or is liable to pay foreign corporation tax abroad is deducted from the tax amount paid or payable abroad is deducted from the corporation tax up to an amount equivalent to the ratio of the income from foreign sources to the total taxable income. If the foreign tax amount paid or payable exceeds the prescribed creditable limit against the corporation tax payable for the year, the excess portion may be carried over for 5 years.

Tax credit for loss caused by disaster

Where a domestic corporation is deemed to have difficulties in paying tax because it has lost 30% or more of the total value of its assets due to a natural disaster, a tax amount equivalent to the ratio of the value assets loss to the value of total assets is deducted from corporation tax. The

amount of tax credit available is limited to the value of the asset loss caused by disaster.

Reduction or Exemption

The corporation tax may be reduced or exempted for the following business:

- a. A business of industry–supporting service which is vital to the strengthening of international competitiveness of domestic industries, and a business accompanying high-level technology. (RSTA(Restriction of Special Taxation Act),Art. 121-2)
- b. A business carried on by foreign-invested enterprise which moves in a foreign Investment zone. (RSTA(Restriction of Special Taxation Act),Art. 121-2)

VAT

Taxpayers

- 1) A person who engages in the supply of goods or services independently in the course of business, whether or not for profit, is liable to value added tax.
- 2) Taxpayers include individuals, corporations, national and local governments, associations of local authorities, any bodies of persons, and unincorporated foundations of any other organizations are generally subject to Value Added Tax.

Taxable Period

The taxable period for VAT is divided into two.

- 1) First period: January 1 to June 30
- 2) Second period: July 1 to December 31

* VAT reports should be filed to a tax office on a quarterly basis.

Taxable Transactions

Value added tax is imposed on the following transactions:

- 1) the supply of goods and services
- 2) the importation of goods.

Zero-Rating and Exemptions

Zero-Rating

The supply of the following goods and services is zero-rated and the input tax incurred is refundable. Zero rating is applicable only to traders who are residents or domestic corporations.

However, in the case of international transportation service by ships or aircraft, traders who are non-residents or foreign corporations are subject to zero-rating on a reciprocity basis.

Goods for exportation:

- Services rendered outside Korea
- International transportation service by ships and aircraft
- Other goods or services supplied for foreign exchange earning.

Exemption

The supply of the following goods services is subject to exemption and the input tax incurred thereon is not refundable. However, traders may elect not to be exempted.

- Basic life necessities and services, Social welfare services
- Goods or services related to culture, Personal services similar to labour
- Other goods or services, Duty-exempt goods.

Tax Base and Assessment

Tax Base

The tax base of valued-added tax for the supply of goods or services is an aggregate amount of the value as specified under the following. However value-added tax is not to be included in the base.

- If the supply is for a money consideration, its consideration
- If the supply is for a non-monetary consideration, its open market value
- If the actual consideration is considered to be unduly less than that which might reasonably be expected or if there is no consideration, its open market value
- In the case of the inventory goods at the time of the closing down of a business, the open market value of the inventory goods

Tax rate

The rate of value-added tax is 10%

Amount Payable

The amount of value-added tax is computed by deducting the input tax amount under the following items business from the output tax amount chargeable on the goods and services supplied by the tax payer. The input tax which exceeds the out put tax is refundable.

The Law for the Coordination of International Tax Affairs Transfer Pricing Regime

i) Adjustment of a Transfer Price Based on an Arm's Length Price

The LCITA (Law for the Coordination of International Tax Affairs) authorizes the tax authorities to adjust the transfer price based on an arm's length price (ALP) and to determine or recalculate a resident's taxable income when the transfer price of a Korean company and its foreign counterpart is either below or above an arm's length price.

- (1) Special Relationship
- (2) Computation of Indirect Ownership

ii) Criteria and Procedure for Transfer Price Adjustment

The LCITA and its Decree define an arm's length price (ALP) as a price that is established or that can be expected to be established in a normal transaction between independent enterprises without a "special relationship."

The LCITA lists the following methods for determining an ALP: the comparable uncontrolled price (CUP) method, the resale price method, and the cost-plus method. Furthermore, the Decree elaborates upon the profit-split method, the transactional net margin method (TNMM) and the Berry Ratio method as methods for determining an ALP based on profits arising from controlled transactions.

The CUP method evaluates an ALP by comparing the price that an independent uncontrolled person under the same or similar circumstances in terms of trade conditions or volume would set for goods identical to those in question.

The resale price method may be applied where a manufacturer sells its products to a related person and the related person resells the same product to an unrelated third party without any further processing. Under this method, the adjustment in the transfer price between related parties may be computed by subtracting an appropriate mark-up amount from the price that the related reseller charges the product to unrelated third parties.

The cost plus method, in principle, may be applied where a manufacturer sells his or her products to the related party and the related party then adds value to the product by processing it further to sell to unrelated third parties. In such cases, the ALP is calculated as the price of the refined goods, less the actual costs of further processing, together with an appropriate mark-up upon such costs.

The profit split method determines an ALP by taking the sum of profits earned by the related parties and allocating them in proportion to the respective contribution towards generating the profits realized.

The TNMM evaluates an ALP by first seeking an independent third company which is similar to the company at issue in terms of its business operations and the nature of its business, and then by subjecting such a company to functional and comparability analyses. The income earned by the third company is then estimated based upon the following ratios: profits to assets, operating profits to turnovers, and profits to equity. These estimates will then be used to evaluate and if necessary, adjust the income and profit of the related parties.

Finally, with the Berry Ratio method, an ALP in a transaction between a Korean company and its foreign related party is established by using the ratio of gross profit to operating expense (GP/OE) in a comparable (the same or similar) transaction between the Korean company and an unrelated party.

iii) Selection of Method for Determining ALP

The Decree states that an ALP should be determined by the most reasonable method applicable to the situation, whether it be the CUP method, the resale price method, the cost plus method, or any other method.

iv) Reporting Methods for an ALP Determination

The method used and the reason for adopting that particular one for an ALP determination must be disclosed to the tax authorities by a taxpayer in a report submitted along with his annual tax return.

v) Advance Pricing Arrangement (APA) System

If a taxpayer wishes to obtain an APA for transactions with its foreign related parties, then he or she should submit an application for an APA to the National Tax Service (NTS) by the end of the first fiscal year concerned (Unilateral APA).

vi) Secondary Adjustment

If the tax authorities adjust the transfer price between a Korean company and its foreign related party based upon an ALP or they increase the taxable income of the Korean company, and if the foreign party has not returned an amount equal to the additional taxable income to the Korean company, the tax authorities will give the foreign related party the 90-day period during which it may return to the Korean company the amount

plus interest accrued up to the point of the return. If the foreign related party fails to do so within the period, the amount equivalent to the additional taxable income will be mostly treated as dividends even if the foreign party is a related company of the Korean company other than a shareholder thereof.

vii) Corresponding Adjustment

The LCITA and its Enforcement Decree state that if a foreign government, on the basis of an ALP, increases the taxable income of a foreign company which is an associated enterprise to its Korean counterpart, the Korean government will correspondingly reduce the taxable income of that Korean company if the two governments have agreed upon an ALP applicable to the case through a Mutual Agreement Procedure (MAP). In such a case, a taxpayer may apply for a downward adjustment in his taxable income by filing a notification of the MAP results with the tax authorities.

viii) Adjustment with regard to a Cost Sharing Agreement (CSA)

International standards used to verify appropriateness of cost sharing between a resident and its foreign related party have been reflected in domestic tax law.

Under the new provision, in case where a resident agrees to develop intangible property jointly with its foreign related party and to share costs/expenses incurred in relation to such development with the foreign related party, the tax base of the resident may be adjusted based on ALP (The shared costs based on the ALP are tax deductible).

Thin Capitalization Rules

i) Outline of Thin Capitalization Rule

A multinational enterprise (MNE) may adopt a tax avoidance mechanism under which the contribution of paid-in capital to its subsidiary in Korea is decreased, while increasing its loans to the subsidiary as much as possible. This may result in the minimization of the taxable income of the subsidiary through the increase in interest expense deduction of the subsidiary. Under such an arrangement, non-deductible dividend payments are replaced with deductible interest payments.

To cope with such an arrangement, the LCITA and its enforcement decree contain thin capitalization rules; whereby if a Korean company borrows from its controlling shareholders overseas (CSO), an amount greater than three times its equity (six times in the case of financial institutions) interest payable on the excess portion of the borrowing, computed as shown below, are re-characterised as dividends to which the article on dividends

in tax treaty applies and therefore are treated as non-deductible in computing taxable income.

For purposes of the thin capitalization rules, money borrowed from a CSO includes amounts borrowed from an unrelated third party based upon the CSO's guarantee.

ii) Debt under an Arm's Length Situation

Although the ratio of debt owed to a CSO to equity exceeds 3:1, as long as the conditions and the amount of debt owed to a CSO are reasonable compared to the debt from an independent third party, such debt from the CSO will be excluded from the scope of the debt subject to thin capitalization rules. As a result, interest on such debt will be deductible. Anti-thin capitalization that originated from the arm's length principle is adopted from Article 9(1) of the OECD Model Tax Convention. Thus, if given requirements are satisfied, the debt-equity ratio prevailing in the industry (rather than a 3:1 or 6:1 ratio) will be applied.

Mutual Agreement Procedure (MAP)

If a Korean resident individual, a domestic company, a non-resident individual or a foreign company with PE in Korea requests that his/her/its case be resolved through consultation with the competent authorities under an applicable tax treaty, the Minister of Finance and Economy or the Commissioner of the National Tax Service shall invoke the mutual agreement procedures (MAP).

International Tax Cooperation

The LCITA and its enforcement decree accept the general principle that income classification under a Korean tax treaty takes priority over that of the domestic tax law.

Under the LCITA and its enforcement decree, the Korean tax authority may request the tax authority of a treaty partner to collect the Korean taxes, subject to any limitations provided for in the treaty. Similarly, if the treaty partner requests the Korean tax authority to cooperate in collecting its taxes from a Korean resident, the Korean tax authority may collect the treaty partner's tax in accordance with the procedure for the collection of national taxes provided in the National Tax Collection Law.

The Korean tax authority may exchange tax information with foreign countries with which Korea has entered into tax treaties, subject to the provisions and limitations of the tax treaties.

If necessary, the Korean tax authority is permitted to 1) simultaneously conduct a tax audit with foreign tax authorities concerned, under the convention for cooperation in tax administration with that foreign country or 2) dispatch Korean tax officials to the concerned foreign country to conduct a direct tax audit of the company in that country.

As of the end of June 2009, Korea entered into bilateral tax treaties (conventions for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital) with 70 countries. In addition to the primary objective of avoiding international juridical double taxation, tax treaties serve purposes such as promoting the introduction of advanced technology and capital from abroad as well as encouraging business expansion of domestic companies in foreign countries.

7. Accounting & Reporting

Financial Accounting Standards, Commercial Code and Tax Law

The production of the financial reports of business activities in Korea is regulated by the Commercial Code, the Corporate Tax Act, the Securities Transaction Tax Act, and the Act on External Audit of Stock Companies, the Certified Public Accountant Act, the Financial Accounting Standards and the Audit Standards.

Although the Commercial Code lists as financial statements the balance sheet, statement of income, and statement of retained earnings or deficit, the Financial Accounting Standards adds to the list the statement of cash flows and notes to financial statements.

Since tax law is based on the major premises of fair taxation and the system in which revenue and expenses are incurred as prescribed in the law, tax accounting is bound to produce figures different from those produced in financial reports in accordance with the Financial Accounting Standards, which are based on the accrual basis and realization principle. The recent trend in legislation, however, is that the gaps between financial accounting and tax accounting are reduced.

Review of Audit Quality Control

As a result of amendments to the Enforcement Decree of the Act on External Audit of Corporations that allowed the FSS (Financial Supervisory Service) to review the audit quality controls of major accounting firms, the FSS conducted an audit quality review accounting firm that qualified for the review. The FSS made recommendations on weaknesses identified during the audit quality review and reported the results to the Securities and Futures Commission. Firms were required to submit follow-up reports on improvements made to their audit quality controls.

A statement of protocol was signed with the U.S. Public Company Accounting Oversight Board to facilitate cooperation in the oversight of auditors and conducted a joint audit quality control review of a U.S. accounting firm in Korea.

Internal Accounting Controls

The FSS prepared guidelines on implementing best practices for internal accounting management at large listed companies as well as SMEs and unlisted companies. Unlisted SMEs were judged to be in compliance with the best practices if they complied with certain requirements under the Act on External Audit of Corporations. The criteria of the Korean Institute of

Certified Public Accountants (KICPA) were also used as a guide when reviewing a company's internal accounting management system.

External Audit

A joint stock corporation whose total asset is equal to or greater than the amount of KRW 10 billion shall be required to have an independent audit of its financial statements (including consolidated financial statements).

International Accounting Standards

IAS (International Accounting Standards) will be adopted in Korea from 2011 mandatorily for all listed companies and from 2009 voluntarily for international listed companies.

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