Doing Business in South Korea

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in South Korea.

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+44 (0)20 7436 6722

Prepared by Woori Accounting Corporation

Background

Country overview

The Korean government has maintained a presidential system, wherein the President is the head of state and chief executive. Under the present system, government power is shared by three branches: the legislative, judicial, and executive. In addition, two other constitutionally based institutions, the constitutional Court and the National Election Commission, also perform governing functions.

The population of the Republic of Korea as of 2016 was 51 million. While rapid population growth once posed a problem, recent family planning campaigns and changing attitudes, have curbed this, with an annual growth rate of only 2.7% in 2016. The Republic does have an ageing population though.

All Koreans speak and write the same language, which has facilitated the development of a strong national identity. There are several dialects, but apart from that of Jeju-do province, they are similar enough to be understood by all native speakers without any difficulties.

Economic overview

Korea's transformation since 1962 from a poor agrarian society to the society it is today has been described as the "economic miracle on the Hangang River". The development has dramatically transformed the Korean economy.

The economic crisis beginning in late 1997 threatened Korea's success, but with the implementation of an IMF agreement, governmental commitment to reform, and negotiation of foreign debt restructuring with creditor banks, the nation remained on track. Since the onset of the crisis, Korea has been integrating itself into the world economy, and attempting to develop an economic structure suitable for an advanced economy.

Transport infrastructure

Korea has air service agreements with 94 countries and major international airlines now offer over 8,560 scheduled direct or non-stop flights per week from Korea to major cities in North America, Europe, the Middle East, and Asia.

A high-speed rail service linking Seoul with the southern port city of Busan was launched in April 2004. This new rail service, dubbed as Korea Train Express or KTX, cut travel time from Seoul to Busan to two hours and 40 minutes from the four and a half hours. The Seoul-Busan travel time will further be cut to one hour and 56 minutes. It is expected to ease current traffic congestion on highways and offer greater convenience to the public.

Lastly, Container ships from Korea utilise the international sea lanes to ports in South and North America, Europe, Australia, the Middle East and Africa. Foreign ocean liners, cruise ships and passenger-carrying freighters also pay frequent visits to Korean ports. A significant increase in annual cargo handling capability of Korea's ports between 2010 and 2016 a reflects the increasing importance of maritime transportation in national development. There is now a major government body responsible for promoting development of the maritime transportation industry.

Choice of Legal Form

The types of business enterprise provided for by the Commercial Code - unlimited partnership, limited partnership, joint stock company, limited partnership, limited liability company - are all available as vehicles for foreign investment. The types are classified according to: (1) whether members' liability with respect to the entity's liability is limited or unlimited; and (2) whether such liability falls directly upon the members' own assets or only indirectly upon the company's property. A joint stock company ("chusik hoesa") is the most commonly selected form of corporate vehicle, as it offers members limited liability and shares are freely transferable.

Joint stock company ("Chusik Hoesa")

Shareholders of the company holding a given capital divided into shares are only liable to contribute up to an amount equal to their share subscription and do not bear any liability with respect to their company's liability. The joint stock company system is appropriate for a large business requiring large amounts of fixed capital and the continued procurement of funds. A joint stock company requires at least one promoter and becomes effectively incorporated after preparation of the articles of incorporation, election of directors and auditors, determination of shareholders, fulfilment of contribution and, lastly, completion of registration of incorporated status.

Limited company ("Yuhan Hoesa")

As in the case of a joint stock company, the liability of all members is limited to the amount of their contribution to the company. The individual character of each member is taken more into account, transfer of equity is limited, and the company is not open to the public (unlike a joint stock company). Therefore, this type of company is appropriate for the operation of a small or medium-sized business owned by a small number of persons. Promoters are not separately required, but all members prepare the articles of incorporation and act as promoters at the time of incorporation. There is no system for scrutiny of the incorporation process, at least one member of the company prepares the articles of incorporation, and all members put their names and affix their seals thereto. Directors and auditors are elected, capital contribution is made, and the incorporation of the company is effected upon registration of the incorporation.

Unlimited partnership ("Hapmyung Hoesa")

The business consists of members bearing direct, joint and unlimited liability with respect to the business's creditors. In principle, all members bear rights and obligations with respect to implementation of the partnership affairs and the representation of the partnership. This type of business is appropriate for an enterprise jointly owned by a small number of persons whose personal relationship is very close. Each member bears unlimited liability and thus need not pay in capital prior to formation of the partnership. Contribution of credit or labour is possible, and there is no inspection procedure by a court. Also, all the members execute partnership affairs and thus need not form an executive organ prior to formation of the partnership. At least two members jointly prepare the establishment document, all members put their names and affix their seals or signature, and the partnership is formed upon registration.

Limited partnership ("Hapja Hoesa")

This type of business entity consists of both members bearing direct and unlimited liability and members bearing limited liability. Members bearing limited liability participate in the business only through their capital contribution and have no right to undertake partnership affairs or represent the partnership. This type of business is similar to an unlimited partnership but with a capital contribution required. A limited partnership is formed when at least one member bearing unlimited liability and at least one member bearing limited liability prepare the establishment document and registration is effectuated.

Limited liability company ("Yuhan Chaekim Hoesa")

A limited liability company (LLC) was introduced in the revised commercial law in 2012 as a company form. The internal relationships of the limited liability company are regulated in the same way as Unlimited Partnerships (“Hapmyung Hoesa”) unless there are provisions in commercial law or the articles of incorporation. LLCs have quicker, more flexible and resilient governance than rigid governance of the Joint Stock Company (“Chusik Hoesa”). Investors can participate in the management of a subsidiary directly. Because each employee is responsible for only the amount of the contribution limit, it is suitable for youth ventures with high technology but finding difficulties in the initial commercialization.

Audit Requirements

Corporations subject to external audit

Any stock company in which either:

1) total assets as of the end of the preceding fiscal year are equal to or greater than 12 billion Korean Won,
2) total assets and liability as of the end of the preceding fiscal year are equal to or greater than 7 billion Korean Won,
3) total assets as of the end of the preceding fiscal year are equal to or greater than 7 billion Korean Won and the numbers of total employees as of the end of the preceding fiscal year are equal to or greater than 300,
4) a stock-listed corporation (as defined in the Financial Investment Services and Capital Markets Act), or a stock company that intends to become a stock-listed corporation during the relevant business year or the following business year

shall prepare the financial statements, and have them audited.

Auditor

The auditor qualified to conduct the audit shall be as follows;

1) any auditor who falls under any of the following shall be qualified to conduct the audit on the consolidated or combined financial statements and the financial statements of stock-listed corporations shall be appointed among accounting firms:

- An accounting firm
- An audit team

2) Any certified public accountant capable of performing the auditing duties, but limited to those who have undergone the training in actual businesses as prescribed by the Presidential Decree.

Appointment etc. of auditor

1) Companies that require and audit should appoint an auditor within four months from the commencement of each fiscal year. The same auditor should conduct the audit on the financial statements, consolidated financial statements and combined financial statements.

2) In the selection and appointment of an auditor for listed companies, the audit contract should be approved by the audit committee. For non-listed companies, the audit contract should be approved by the internal auditor or audit committee.

3) Any company shall, when it appoints an auditor, under paragraph (2), report his appointment at an ordinary general meeting of shareholders called after his appointment.

4) If a company appoints a new auditor under the following circumstances, the provisions of paragraphs (1) and (2) shall not apply provided any new auditor appointed for listed companies is approved by the auditor appointment committee:

   a) Where the company replaces the current auditor, and appoints a person nominated by the SFC as an auditor; and

   b) Where an already appointed auditor is unable to discharge his duties as an auditor on the grounds prescribed by the PD, including dissolution of the company during the fiscal year.

5) If a company appoints, or replaces with, an auditor according to each subparagraph of paragraph (4), the appointment shall be made within two (2) months

6) Notwithstanding the provisions of paragraph (2), where a company, which is not a stock-listed corporation, an Association-registered corporation or an affiliated company of an enterprise group to which a company that has been notified by the SFC of the need to prepare a combined financial statement, intends to reappoint the auditor who served as an auditor during the immediately preceding fiscal year, it may decide not to obtain the approval of the statutory auditor or the auditor appointment committee.

Appointment etc. of auditor by stock-listed corporation and association-registered corporation

1) A stock-listed corporation and an Association-registered corporation shall appoint an auditor for the period of three consecutive fiscal years within four months from the commencement of the initial fiscal year.

2) Notwithstanding paragraph (1), if an auditor violates their duties a company may dismiss the auditor upon approval from the auditor appointment

committee within three months after the end of each fiscal year, even during their three consecutive fiscal years.

3) A company shall, when it dismisses the auditor under paragraph (2), file without any delay a report thereon with the SFC.

4) The company adhering to paragraph (1) shall be prohibited from having the same auditor perform the auditing duties in excess of the continued six business years, except in the following cases:

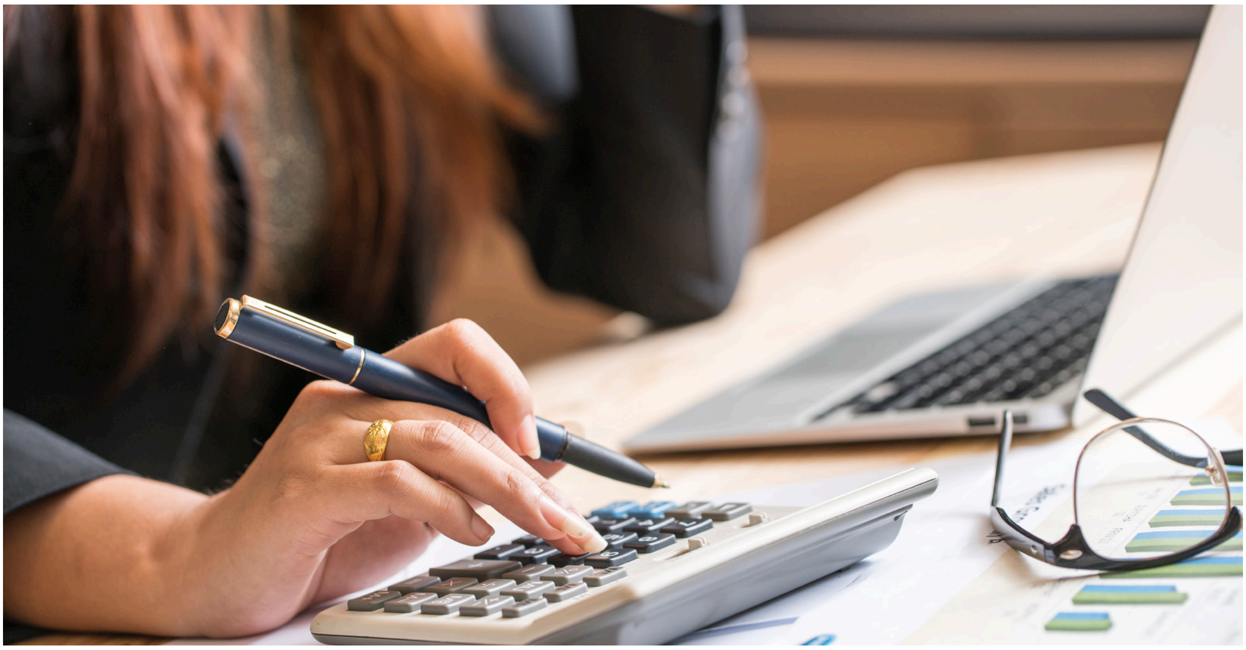
    a) In a foreign-invested company registered under Article 21 of the Foreign Investment Promotion Act for which a continued auditing by the same auditor is inevitable due to the relations with the overseas parent company; and

    b) Where the securities are listed on the foreign Stock Exchange as prescribed by the Presidential Decree (limited to the Stock Exchange which allows the listing of securities only for the enterprises guaranteeing a considerable level of the accounting transparency).

Report on appointment of auditor

If a company appoints or replaces an auditor, the company shall report thereof to the SFC.

Taxation



Taxes in Korea

Taxes in Korea comprise national and local taxes. National taxes are divided into internal taxes, customs duties, and three earmarked taxes; the local taxes include province taxes and city & county taxes as shown below.

National taxes (levied by the central government)

Internal Taxes

- Direct taxes
  Income Tax, Corporation Tax, Inheritance Tax, Gift Tax, Real Estate Holding Tax

- Indirect taxes
  Value Added Tax, Special Excise Tax, Liquor Tax, Stamp Tax, Securities Transaction Tax

Customs Duties

Earmarked Taxes

- Transportation Tax, Education Tax, Special Tax for Rural Development

Local taxes (levied by local government)

Province Taxes

- Ordinary Taxes
  Acquisition Tax, Registration Tax, License Tax, Leisure Tax

- Earmarked taxes
  Community Facility Tax, Regional Development Tax, Local Education Tax

City & County Taxes

- Ordinary Taxes
  Inhabitant Tax, Property Taxes,

Automobile Taxes, Farmland Taxes, Butchery Taxes, Tobacco Consumption Taxes, Motor Fuel Tax

- Earmarked Taxes
  Urban Planning Taxes, Business Place Tax

Administration of the tax system

The Tax Bureau of the Ministry of Finance and Economy is responsible for drafting tax laws, negotiating international tax treaties and for the preparation of the tax revenue section of the national budget. The National Tax Service, an agency of the Ministry of Finance and Economy, oversees the assessment and collection of internal taxes.

The appeal of a contested tax assessment may begin at the district tax office level or at the level of the regional office of the National Tax Service, or the taxpayer may ask for a review directly from the National Tax Service. If these procedures do not resolve the dispute, the taxpayer has the right to file an appeal with the National Tax Tribunal, also an agency of the Ministry of Finance and Economy, but separate from the National Tax Service. If the decision of the National Tax Tribunal is not in favour of the taxpayer, the taxpayer may file an action with the High Court, at which point the issue will be reviewed in a trial de novo. An appeal from the High Court may be taken to the Supreme Court.

An alternative procedure is to appeal a tax assessment directly to the Board of Audit and Inspection, an independent agency directly under the president. An unfavourable ruling before this body may be reviewed by the High Court with right of appeal to the Supreme Court. This appeal procedure is not often used. The primary function of the Board of Audit and Inspection is to audit the operations of other government bodies. Its power to review tax assessments is only a small part of its authority. The National Tax Tribunal, on the other hand, is involved exclusively in the hearing of tax appeals.

The taxpayer is entitled to interest at the statutory rate on any refunds found to be owed to the taxpayer. Interest runs from the due date of the payment, or actual payment date, whichever is later, until the date a vested right to the refund is created in law.

In addition to the remedial procedures available under the Korean statutes, a resident taxpayer may request the National Tax Service's Assistant Commissioner (International), the competent authority of Korea, to initiate mutual agreement procedures (also referred to as 'competent authority assistance procedures') if the taxpayer believes that a foreign tax authority in a jurisdiction with which Korea has a tax treaty in force has taken a position in contravention of the provisions of such treaty.

Pursuant to these procedures, the taxpayer may request that the district tax office delay issuance of a tax payment notice, or extend the time to pay tax after a tax payment notice has been given. Further, the taxpayer may request the authorities to extend the limitation for appeals to the National Tax Service or the National Tax Tribunal. The terms of settlement at the competent authority level may be enforced, irrespective of the running of the statute of limitations, within one year from the date of the settlement.

The tax assessment authority is required to issue a pre-determination notice to the taxpayer before issuing the tax payment notice. This gives the taxpayer an opportunity to file a complaint with the district tax office based on the notice before the actual tax assessment is made.

Filing and payment

A corporate taxpayer must file a tax return and pay corporation tax as set out below.

Corporations required to file tax returns

Filing is required of:

a) any domestic corporation having its main office in Korea;

b) any foreign corporation which maintains a domestic place of business in Korea; and

c) any foreign corporation which has domestic source income from real estate or from forestry.

Kinds of tax returns to be filed

Two types of returns are required:

a) returns for each complete fiscal year; and

b) returns for each six-month period commencing on the first day of the fiscal year of a corporate taxpayer.

The former is referred to as "corporate tax returns," and the latter as "semi-annual tax returns." Whenever a taxpayer's fiscal year exceeds six months, except for the first fiscal year, a semi-annual as well a corporate tax return must be filed.

Documents to be submitted

A tax return consists of a corporation tax and taxable income report form, other detailed schedules as specified in the Enforcement Regulation of the Corporation Tax Law, and financial statements prepared in conformity with the Korean Business Accounting Principles. Among the financial statements required are balance sheets, profit and loss statement, and statement of appropriation of earned surplus (or statement of disposal of deficit).

Corporate taxpayers having transactions with foreign parties in a special relationship during the fiscal year are required to report such transactions to be filed with the annual return.

Deadline for submission

A corporate taxpayer preparing its own tax return or prepared by an approved preparer is required to file within three months from the end of its fiscal year.

Payment upon filing of tax returns

As a general rule, corporation tax must be paid on filing the tax return and no later than the deadline for filing. A corporate taxpayer may elect to pay the tax on an instalment basis if the corporation tax payable exceeds 10 million won. In such a case, a portion of the corporation tax may be deferred for 1 month from the date of filing the tax return. Certain small corporations, as defined in the statute, may defer payment of tax for 2 months.

Semi-annual tax returns

A corporate taxpayer is required to file a semi-annual tax return if its fiscal period exceeds six months. Corporation tax payable on filing a semi-annual tax return is based on 50% of the corporation tax paid in the preceding fiscal period. This amount may vary if the preceding period is not a full calendar year. If a taxpayer determines that the amount of corporation tax to be paid based on the 50% rule is greater than the amount of corporation tax based on the actual profit or loss shown on its books for the pertinent 6-month period, the taxpayer may file the semi-annual tax return on the basis of its financial statements and pay corporation tax on the taxable income so computed. For interim payments, filing and payment is required within two months after the end of each six-month period.

Amended tax returns

A taxpayer may file an amended tax return showing entitlement to a tax refund or an increase in loss within three years from the statutorily determined deadline for filing the initial tax return. On the other hand, an amended tax return showing an additional tax payment or a decrease in loss may be filed at any time before the tax office advises the taxpayer of an adjustment as a result of the re-determination process. Filing an amended tax return may permit the taxpayer to reduce certain tax penalties.

Allowances

Incentives on foreign investment in Korea

Tax reduction & exemption for foreign investment companies or corporations

The Korean government supports foreign-invested companies operating in Foreign-Investment Zones with tax reductions or exemptions and privileges such as construction costs, basic facility support, and exemption of the traffic generation charge. Details of the available tax reductions and exemptions are as follows:

Corporate Tax, Income Tax:

- Until the end of 2004, if a foreign-invested company reports and applies for a tax reduction/exemption from the Korean government, a 100% exemption for the initial 7 or 3 years and a 50% exemption for the following 3 or 2 years was available.
- From 1 January 2005, if a foreign-invested company reports and applies for a tax reduction/exemption from the Korean government, a 100% exemption for the initial 5 or 3 years and a 50% exemption for the following 2 years will be available

Property Tax, Acquisition Tax, Aggregate Land Tax, Registration Tax:

- Until the end of 2004, if a foreign-invested company reports and applies for a tax reduction/exemption from the Korean government, a 100% exemption for the initial 5 or 3 years and 50% exemption for the following 3 or 2 years was available.

- From 1 January 2005, if a foreign-invested company reports and applies for a tax reduction/exemption from the Korean government, a 100% exemption for the initial 5 or 3 years and a 50% exemption for the following 2 years will be available.
- A local government can increase the reduction/exemption period and percentage for the period up to 15 years.

Tax support for foreign investors' dividends

For dividends received by foreign investors from a foreign-invested corporation that is engaged in businesses and eligible for corporate or income tax reduction or exemption, tax will be reduced or exempted based on the rate of income generated by the foreign-invested corporation from its operation of business that is eligible for corporate or income tax reduction or exemption.

The initial date in reckoning for tax reduction or tax exemption of dividends generated by new investments and capital increase through paying actual money, actual shares and dividends is same as the initial date in reckoning the corporate tax. During the period when the corporate tax is exempted 100%, the dividend income tax will also be exempted 100%. During the period for 50% reduction on the corporate tax, the dividend income tax will also be reduced 50%.

In the case where a foreign investor takes over the shares of a foreign-invested company from a local individual or a local corporation, it is regarded as acquisition of existing shares. Therefore, it is not eligible for the tax reduction or tax exemption. However, in the case where a foreigner or a foreign corporation takes over the shares of a foreigner or a foreign corporation, the original period and rate for tax reduction and tax exemption remain effective.

Tax exemption on advanced foreign technology

Where highly advanced technology, which is judged critical for enhancing Korea's global competitiveness, is introduced following an agreement, the provider's (individual, corporation, international organization) corporate tax and income tax will be exempted for seven years from the date which the initial compensation for introducing the technology is to be made.

Tax support for foreign technicians

A foreign technician will be exempted from earned income tax if he/she renders his/her service to Koreans in Korea pursuant to the technology introduction agreement stipulated in the FIPA. However, the privilege shall remain effective only for two years to the month of the issuing date of certificate of report for the technology introduction agreement under the condition that the agreement is observed.

Expansion of scope for tax exemption on foreign workers' overseas allowance

The recipient of this benefit can choose to pay either income tax on 17% of their gross salary or 6% to 38% of their salary which is the tax rate applicable to Koreans.

Employment

Employment insurance

Employment insurance is a social security program which was adopted in July 1995 to enhance competitiveness by supporting unemployed workers, preventing unemployment resulting from industrial restructuring, and promoting reemployment as well as instituting various support programs for employers.

Any business employing one or more workers is obligated to purchase employment insurance (agricultural, forestry, fishery and hunting industries employing four full-time workers or less and construction sites where the total contract price is less than the amount announced by the MOL each year are exempt but may purchase the coverage of their own volition). The employer is required to file an Insurance Coverage Notice with the regional headquarters of the KLWC and an Insurance Eligibility Notice with the Employment Stabilization Centre at the local labour office within 14 days. The employer must also notify the regional headquarters and branch office of the KLWC of the estimated premium and pay it to any financial institution entrusted to transfer payments to the treasury within 70 days of the day on which the insurance is applicable.

Employment permit system

The Employment Permit System permits employers who have failed to hire native workers, to legally employ certain number of foreign workers. Under the System, the Government assumes the responsibility for attracting and managing foreign workers.

With the introduction of the Employment Permit System, small and medium businesses are able to minimize labour shortages and foreign workers will enjoy basic rights under labour relations laws.

Payroll taxes on non-residents

Wage and salary income in Korea tax

Class A

- Wage, salary, remuneration, allowance, bonus, and any other allowance of a similar nature received in return for services
- Income, other than retirement income, received due to retirement

Class B

- Wage and salaries received from a foreign agency or from the U.N. Forces in Korea (excluding the U.S. Armed Forces)
- Wage and salaries received from a foreigner of foreign corporation outside Korea, excluding those claimed as a deductible expense for a Korean place of business of a non-resident of a foreign corporation.

Non-resident who has class a wage and salary income only

Taxation methods applied for non-residents who have Class A wage & salary Income only are the same as residents. That is to say, an employer who pays a monthly wage to their employees shall withhold a tax amount monthly based on the Simplified Tax Table issued by the National Tax Service, the total amount of which is regarded as a credit taken off for their ultimate tax responsibilities. When the employer pays wages in the next January of the taxable year, they shall calculate the gross tax liabilities of their employees on behalf of them, from which the withheld amount shall be deducted to bring forth the final tax amount to be paid. This is called the 'Year-end Settlement'.

Non-resident who has class b wage and salary income only

A non-resident who has Class B Wage & Salary Income may organize or join a taxpayer association to settle their tax liability. In this case, the association withholds income tax monthly on the Class B Wage & Salary Income of its association members and pays the amount to the tax authority concerned by the 10th of the next month. Like Class A Wage & Salary Income, the Class B Income is subject to the Year-end Settlement and eligible for Taxpayer Association Tax Deduction but, as stated above, the basic deduction, additional deduction and special deduction are not generally allowed.

Withholding Taxes

A person paying the following income to a domestic corporation is required to withhold corporation tax/income tax on the income at the prescribed tax rates at the time of such payment, and pay it to the government by the 10th of the following month.

Interest

Corporation Tax/ Income Tax

- Interest prescribed by the Income Tax Law: 14%
- Interest from a non-commercial loan: 25%

Dividends

Income Tax/ Corporation Tax: 14%

This document is provided as a general overview of matters to be considered when setting up an overseas business in South Korea. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided in this publication.

If you are setting up a business in South Korea, the members of DFK International can help you to achieve this efficiently. You will receive practical advice on business issues, tailored to meet your objectives, from experienced business advisers.

For further information on the services available from the DFK member firms in South Korea please see the following page.

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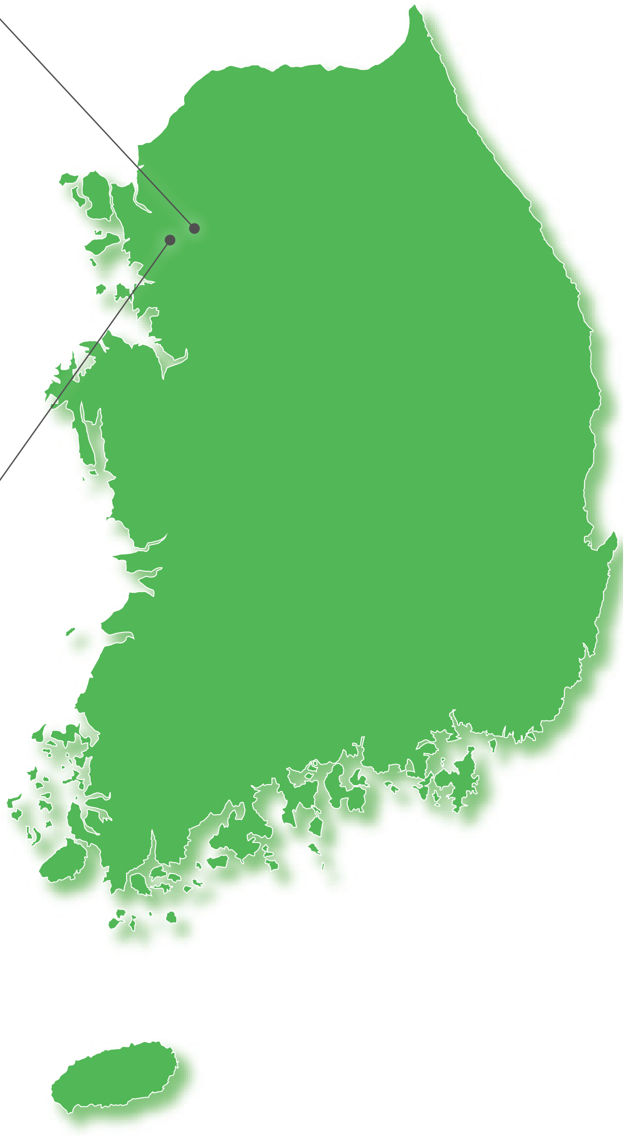
dfk.com
+44 (0)20 7436 6722

Seoul

Woori Accounting Corporation
Brian Jang
jang10091@naver.com
+82 (0)2562 2792
www.wooricpa.co.kr



Youngdeongpo-ku

Woori Accounting Corporation
Hyun-tae Lee
htleecpa@unitel.co.kr
+82 (0)2216 58828
www.wooricpa.co.kr