



October 9, 2007

*This publication contains information on selected current developments in Korean taxation, laws and regulations compiled by the tax service group of Samil PricewaterhouseCoopers, a network firm of PricewaterhouseCoopers.*

## Contents

### MOFE's Proposed Rules for Partnership Taxation in Korea

## MOFE's Proposed Rules for Partnership Taxation

The Ministry of Finance and Economy (MOFE) has submitted a draft bill to revise Special Tax Treatment Control Law (STTCL) to the National Assembly in early October. And the new bill includes new provisions on the long awaited partnership taxation. If approved by the National Assembly by the end of December, the proposed partnership rule will become effective from fiscal years beginning on or after January 1, 2009.

The MOFE's bill contains some newly proposed rules on partnership taxation as well as those that were already widely publicized prior to the finalization of the draft bill. Provided below are summarized key points of the Korean partnership taxation rules proposed by MOFE.

**Entities Affected** The new partnership taxation rules would apply to an association (*Johap* in the Civil Law), an anonymous association (*Ikmyong Johap* under the Commercial Code), an unlimited company (*HapmyongHoesa* or *HapjaHoesa* under the Commercial Code), and some YuhanHoesa (YH company) engaged in rendering personal services (e.g. accounting firms, law firms, tax accounting firms, etc.) that are meeting certain conditions. Limited Partnership (*Hapja Johap*) and Limited Liability Company may be eligible for the new partnership rule once the relevant revision to the Commercial Act on those new entity forms passes the National Assembly.

**Avoidance of Double Taxation of Income** A partnership would be treated as a flow through entity, not subject to corporate income tax. Each partner would be subject to corporate income tax or individual income tax on the relevant share of the profit.

However, when a partnership subject to this new rule participates in another partnership, this new rule of partnership taxation may not apply to such another partnership (i.e. in this case the upper level partnership shall directly recognize the incomes and expenses of the lower level partnership to the extent of its profit/loss allocation ratio as if it were a branch office). It is intended to prevent partners from taking advantage of partnership benefits in such a way to avoid tax by forming a multi-level partnership.

An eligible entity that elects to be taxed as a partnership would be required to make an application with the concerned tax office. The election would be valid for five consecutive years and may not be rescinded during the effective period.

**Allocation or Classification of Income or Loss** Income or loss of a partnership would be allocated to the partners according to the agreed profit/loss allocation ratio. Whether a different allocation ratio would be allowed for losses is still under contemplation by MOFE. But losses would only be allocated to the extent of the partner's outside basis (i.e. the book value of the respective partner's partnership interest for tax purposes) as of the closing day of the concerned tax year of the partnership. Losses in excess of the outside basis would be carried forward for five years.

**Passive Investment Partner** Passive investment partners would be excluded from the allocation of losses. And the income allocated to passive investment partners would all be classified as dividend income. Under the proposed bill, passive investment partners are defined as those who make contributions to a partnership but do not take part in the management of partnership excluding the partners:

- who allow the use of his or her name or trade name for the partnership's business; or
- who agree to take unlimited liability for the obligations incurred from the partnership's business.

New considerations may (or may not) be added on the judgment of a passive investment partner depending on the future development of the partnership taxation rule.

**Grouping of Partners** Partnership income would be allocated to partners at the end of the partnership's tax year. In calculating the amount

of income to be allocated, partners would be grouped into four different categories according to the same taxation scheme (tax rates, income classification, etc.): residents; non-residents; domestic corporations; and foreign corporations. The grouping would allow several partners to be treated as one partner. Income then would be allocated according to the respective partners' profit/loss allocation ratio.

The tax credits, exemptions or reductions, withholding tax (which is imposed on a partnership at the receipt of interest income) and penalties would also be allocated according to the respective partners' profit/loss allocation ratio.

**Transactions between Partnership and Partners**

In certain transactions between a partner and the partnership (to be) specified in the Presidential Decree, the partner would be treated as not being a member of the partnership, but being a third party. And the precondition for this third party treatment is that the partner is not acting in capacity of a partner.

Such transactions would be treated as executed between third parties and therefore income arising or expenses incurred from the transactions would be recognized.

Transactions between a partnership and its partners would be no exception to the existing rule for denial of unfair trade between related parties under the Corporate Income Tax Law. This means that a partner and the partnership would be regarded as related parties and be taxed accordingly if a transaction is found to be made in such a way to unreasonably reduce tax burden (e.g. transfer of assets by the partnership to a partner at a lower price than the fair market value).

**Capital Gain on the Disposition of Partner's Interest**

Any gain from the sale of a partner's interest would be taxed as capital gains in the same way as the gain from the sales of shares or interest in a corporation. Loss from

the sale of a partner's interest would be deductible from the capital gains earned by the partner from the sale of other shares or interest of the same kind (individual partner) or from the corporate taxable income for the respective year (corporation partner).

**No Provision on In-kind Contribution to Partnership** As the MOFE bill is silent on in-kind contribution to a partnership, it is interpreted that any gain from in-kind contributions to partnership (i.e. the difference between the FMV of the relevant asset at the time of contribution and the acquisition cost) would be taxed when assets are contributed.

**Adjustment of Partner's Outside Basis** A partner's outside basis may be increased or decreased (but never below zero) by the following items.

- Additional partnership interest acquired through additional contributions to the partnership, purchase, inheritance or gift of the interest;
- Partner's distributive share of taxable and non-taxable partnership income
- Assets distributed to a partner by the partnership
- Partner's distributive share of the partnership losses

Adjustment of a partner's outside basis for its portion of the partnership liabilities is still under contemplation by MOFE and it is expected to be addressed in the Presidential Decree.

**Distribution of Assets** When assets are distributed to a partner by a partnership, the difference between the market price of distributed assets and the partner's outside basis would be taxed as dividends. If the market price of distributed assets is lower than the partner's outside basis, a capital loss can be recognized by the partner only when the assets are distributed in the course of partnership liquidation or the partner retiring from the

partnership.

**Information Return Requirements** A partnership would be required to file its information return with the concerned tax office together with its balance sheet and income statement duly prepared in accordance with the financial reporting standards, outside basis adjustment statement and other documents as required by the Presidential Decree. The information return shall be filed by the 15<sup>th</sup> of the third month after the partnership's fiscal year-end.

**Withholding Tax on Income Allocated to Non-resident or Foreign Corporations** A partnership allocating income to partners who are non-resident or foreign corporations would be required to withhold income tax at the time of filing its information return (or at the time of allocation of non-filed income to partners).

The applicable tax rates would be:

- 25% (for a corporate partner) or 35% (for an individual partner) if the allocated income is attributable to the paid partner's permanent establishment in Korea.; or
- the withholding tax rates on a non-resident or a foreign corporation as prescribed in the Individual Income Tax Law or the Corporate Income Tax Law unless such income is attributable to a PE of the non-resident or the foreign partner, regardless of exemptions, non-taxation or reduced rates as agreed in a concerned income tax treaty,

Non-residents or foreign partners would be able to enjoy benefits of the treaties by filing a request for reassessment within three years from the closing day of the month in which the tax is withheld. The determination on whether the reassessment request may be accepted would be delivered within six months from the date the request is filed.

**Penalties** The penalty against the non-compliance with information return requirements or filing inaccurate returns would be: 4% of the amount of income to be filed (for non-compliance); or 2% of the amount of income which should have been correctly filed (for inaccurate return).

The penalty against the non-compliance with the withholding requirements would be the greater of the followings (which should be limited not to

exceed 10% of the unpaid or underpaid tax):

- Unpaid or underpaid withholding tax x the number of days remained unpaid or underpaid x the interest rate on loans overdue as designated by the Presidential Decree (0.03% per diem); or
- 5% of the amount of unpaid or underpaid withholding tax

The information contained in this publication is for general guidance on matters of interest only and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. For more information, please contact your usual Samil PwC client service team or professionals listed below.

David Jin Young Lee	82- 2-709-0557,	<a href="mailto:jylee@samil.com">jylee@samil.com</a>
IHwan Oh	82-2-709-0897	<a href="mailto:ih_oh@samil.com">ih_oh@samil.com</a>
Dong-Keon Lee	82-2-709-0561,	<a href="mailto:dklee@samil.com">dklee@samil.com</a>
Dong-Bum Kim	82-2-709-7900,	<a href="mailto:dbkim@samil.com">dbkim@samil.com</a>
Sang-Keun Song	82-2-709-0559,	<a href="mailto:sksong@samil.com">sksong@samil.com</a>
Alex Joong-Hyun Lee	82-2-709-0598,	<a href="mailto:alexlee@samil.com">alexlee@samil.com</a>
Shin-Jong Kang	82-2-709-0578	<a href="mailto:sjkang@samil.com">sjkang@samil.com</a>
Sang-Do Lee	82-2-709-0288	<a href="mailto:sdlee@samil.com">sdlee@samil.com</a>

## SamilPwCAcademy Programs

### 2007 년 10 월의 교육프로그램

#### 법인세 실무 10월 8일 (월) ~ 10월 12일 (금) 총 5 일 (31시간)

법인세법 핵심내용의 사례 및 쟁점별 해설, 실무에서 자주 발생하는 최신 예규, 국세심판사례, 대법원판례 해설, 기업회계와 세무회계의 차이분석

#### 원가계산 및 분석실무 10월 9일 (화) ~ 10월 12일 (금), 4일간 총 24시간

원가계산 방법론 및 의사결정기법, 효율적인 원가계산시스템 구축 및 원가절감기법, 기업의 성공적인 원가관리기법 사례 연구

#### 재무회계입문 10월 10일 (수) ~ 10월 12일 (금), 3일간 총 21시간

회계보드게임을 통한 회계의 흐름에 대한 입체적인 이해, 복식부기의 원리에 대한 체계적이고 상세한 해설 및 사례연습, 전표작성, 결산절차 및 재무제표 작성원리 과정, 계정과목 해설

#### 세무실무기초 10월 15일 (월) ~ 10월 18일 (목), 4일간 총 24시간

세무전반에 대한 이해를 돕기 위해 원리에 대한 상세한 설명, 신고서 작성 등 실무 초보자를 위한 기초지식 (소득세와 원천징수세, 부가세실무 등)

#### 계정과목별 회계와 세무 10월 16일 (화) ~ 10월 19일 (금), 4일간 총 28시간

기업회계기준 및 기업회계기준서의 계정과목별 회계처리, 계정과목별 세무조정사항 및 세무 유의사항, 재무회계 핵심논점

#### 원천징수 실무 10월 16일 (화) ~ 10월 19일 (금), 4일간 총 24시간

법인세 및 소득세법의 기본개념의 실무적인 해설, 원천징수 실제사례의 업무 프로세스별 해설, 소득종류별 원천징수방법의 사례

#### M&A전략전문가 과정 (야간) 10월 17일 (수) ~ 11월 14일 (수), 13일간 총 39시간

M&A관련 전략, 법률쟁점, 조직관리 등 사례를 통한 제반 Process, 성공적인 M&A 전략수립 Process, M&A와 Financing, 기업가치평가에 의한 M&A전략 제고, 재무구조조정과법정관리 M&A

#### 사례 중심 별 부가가치세 실무 10월 19일 (금) ~ 10월 19일 (금), 1일간 총 7시간

개정된 부가가치세법, 시행령 및 시행규칙을 반영한 실무, 세액의 계산과 신고납부 등 실무상 유의해야 할 예규와 판례

위의 교육과정은 이론 및 실무, 그리고 사례 연구 등 실무능력향상에 중점을 둔 교육으로 「고용보험법 및 근로자 직업훈련촉진법」에 의해 교육훈련비의 일부를 정부로부터 지원 받는 교육과정으로 지정되어 있으며 (일부 과정은 제외) 교육 7일 전까지 신청하셔야 교육훈련비의 일부를 지원 받으실 수 있습니다. 자세한 사항에 대한 문의는 ☎: 02-3781-3429로 하시기 바랍니다.