Global Business & Development Law Journal

Volume 3 | Issue 1 Article 5

1-1-1990

Legal Aspects of Establishing a Business Presence in the Replublic of Korea

Chang Hee Lee
Seoul National University

Byoung Kook Min
Seoul National University

Legal Aspects of Establishing a Business Presence in the Republic of Korea

Chang Hee Lee* and Byoung Kook Min**

I. Introduction

Development of international business relations may be separated into several stages. The simplest business relationship is the occasional export or import of commodities. If the sales to a particular country expand to reach a substantial volume, the exporter may want a more stable foundation to effect continuous transactions. The usual approach is to create a local commission agent or a distributorship arrangement. Conversely, if a foreign entity desires to procure Korean products on a regular basis, the foreign purchaser will identify a local supplier and establish a long term supply agreement. A local agency or an independent distributorship does not involve a legal presence in Korea.

A major commitment to the Korean market, however, necessitates the establishment of a legal presence in Korea in the form of a liaison office, branch office or a sales subsidiary incorporated in Korea. At the end of the progression is a production and marketing base in Korea which is fully integrated into the multinational network of the foreign investor. Such a move involves a substantial financial investment, and raises a number of complex legal issues, not only in the home jurisdiction of the foreign investor, but also in the host country, Korea.

---

* LL.B., Seoul National University; Certified Public Accountant and member of the Korean Tax Bar; Associate, Min, Sohn & Kim, Seoul, Korea.

** LL.B., LL.M., Seoul National University; M.C.J., LL.M., New York University; Senior partner of Min, Sohn & Kim, Seoul, Korea; and former Civil District Court Judge, Seoul Civil District Court.

In this overview, no attempt is made to address all the legal issues raised in connection with a local business presence. Our comments are confined to Korean law and the Korean business environment. Legal issues arising in the home country are not analyzed. Further, the discussion of Korean law is confined to the factors which may affect the foreign party's feasibility assessments and strategic investment decisions. In Korea, there are a multitude of acts, decrees, rules, and regulations impacting international business operations. Among the important statutes are the Commercial Code (KCC),[1] the Foreign Exchange Control Act (FECA),[2] the Foreign Capital Inducement Act (FCIA),[3] the Foreign Trade Act (FTA),[4] and the Anti-Monopoly and Fair Trade Act (Fair Trade Act).[5] No less important are the laws and the treaties governing taxation in Korea. As of the end of 1989, Korea has entered into bilateral tax treaties with most of the industrialized countries, including the United States, Japan, the United Kingdom, Sweden, Switzerland, Australia, Finland, and Singapore.[6]

Once the level of business transactions with Korea has become relatively high, the question of whether to establish a Korean legal presence arises. Effective operations in the local market are seldom possible without a stable business base in the host country. In Korea, such a stable business base must satisfy relevant legal formalities, since Korean law does not permit foreign enterprises to do business in Korea without a lawfully established business presence. In the discussion that follows, various options available to businesses interested in establishing operations in Korea are presented, and their legal characteristics are reviewed.

1. SANG BEOB [COMMERCIAL CODE], Law No. 1000 (Jan. 20, 1962), *as amended by* Law No. 3724 (Apr. 10, 1984) [hereinafter KCC].

2. WAEGOOKHWAN GWANRI BEOB [FOREIGN EXCHANGE CONTROL ACT], Law No. 933 (Dec. 31, 1961), *as amended by* Law No. 1920 (Mar. 30, 1967) [hereinafter FECA].

3. WAEJA TOIB BEOB [FOREIGN CAPITAL INDUCEMENT ACT], Law No. 3691 (Dec. 31, 1983), *as amended by* Law No. 4128 (June 16, 1989) [hereinafter FCIA].

4. DAEWAE MUYEOK BEOB [FOREIGN TRADE ACT], Law No. 3895 (Dec. 31, 1986), *as amended by* Law No. 4145 (Dec. 21, 1989) [hereinafter FTA].

5. TOPKJEOM GYUJE MIT KONGJEONG KOERAE AI KWANHAN BEOBRYOOL [ANTI-MONOPOLY AND FAIR TRADE ACT], Law No. 3320 (Dec. 31, 1980), *as amended by* Law No. 4198 (Jan. 13, 1990) [hereinafter FAIR TRADE ACT].

6. The citations to the treaties are: U.S.A.: Treaty No. 693 of Sept. 26, 1979; Japan: Treaty No. 356 of Sept. 29, 1970; United Kingdom: Treaty No. 633 of Apr. 21, 1978; France: Treaty No. 732 of Jan. 17, 1981; Germany: Treaty No. 634 of May 4, 1978; Canada: Treaty No. 725 of Dec. 26, 1980; Netherlands: Treaty No. 740 of Apr. 11, 1981; Norway: Treaty No. 835 of Feb. 10, 1984; Sweden: Treaty No. 785 of Aug. 27, 1982; Switzerland: Treaty No. 739 of Apr. 4, 1981; Australia: Treaty No. 823 of Nov. 16, 1983; Finland: Treaty No. 765 of Dec. 11, 1981; Singapore: Treaty No. 737 of Feb. 20, 1981.

II. Liaison Office in Korea

As a preliminary step, before establishing a regular business presence on a significant scale, a foreign enterprise may be interested in opening a local liaison office in Korea. The option for "testing the waters" is commonly used by small businesses as well as by larger enterprises that desire to conduct exploratory operations prior to making a decision on a major commitment to the Korean market.

A. Definition of a Liaison Office

A "minimalist" form of legal presence in a host country is a liaison office, which may be defined as a nonjurisdictional presence that permits a foreign company's employees to reside in the host country, while not being regarded as "doing business" under local law. In other words, a liaison office performs only nontaxable liaison activity in the host country. The permitted scope of functions of a liaison office depends on the law of the host country, given that "doing business" or the taxability of a certain activity is decided by that body of law (including applicable tax treaties). Subject to certain variations among treaty provisions, the general requirements for the nontaxability of liaison office activities under Korean law may be summarized as follows.

First, a liaison office is permitted to work only for its home office, including branches thereof.[7] Korean law restricts the capacity of liaison representatives to work simultaneously for separately incorporated affiliates, even if those representatives are under common control abroad. If a foreign entity, X, has established its liaison office, X^1, in Korea, X^1 is allowed to work only on behalf of X. If X^1 functions for Y, an affiliate of X, that activity performed for the benefit of Y is a taxable activity in Korea. If X^1 has been working for Y without compensation, the tax authorities will impute to X^1 a reasonable profit for that activity on behalf of Y.[8] Accordingly, if X^1 is intended to provide services for Y, X^1 and Y must execute an

---

7. Ministry of Finance (MOF) Ruling of Jan. 9, 1978, Gukjo 1234-44. *See also* OECD Model Commentary 25 on Article 5.

8. *See* Peobinse Beob [Corporate Income Tax Act], art. 20, Law No. 1964 (Nov. 29, 1967), *as amended by* Law No. 4020 (Dec. 26, 1988) [hereinafter CITA]. Corporate Income Tax Act Enforcement Decree, art. 46(1), Presidential Decree No. 3319 (Dec. 30, 1967), *as amended by* Presidential Decree No. 12878 (Dec. 30, 1989)[hereinafter CITA Enforcement Decree]; National Tax Administration (NTA) Ruling No. 943 of Feb. 13, 1985.

agreement under which X[1] will receive a certain commission from Y. As a result, X[1] loses its status as a liaison office, and acquires a taxable presence in Korea. If Y is selling or purchasing products from Korea, the commission payable to X[1] should be based upon the amount of sales or purchases achieved by Y, with assistance by X[1]. In the event of a nonaffiliate transaction,[9] cost plus fee or any other method may also be adopted.

Second, the activities of a liaison office are restricted to a "liaison" nature. The scope of nontaxable liaison activities is defined in the pertinent tax treaty and in the Corporate Income Tax Act.[10] For example, the Korea-U.S. Tax Treaty specifies that "permanent establishment" does not include a fixed place of business used only for the following:[11]

> (a) The use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the resident;
> (b) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display, or delivery;
> (c) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;
> (d) The maintenance of a fixed place of business for the purpose of purchasing goods or merchandise or for collecting information for the resident;
> (e) The maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident; or
> (f) The maintenance of a building site or construction or installation project which does not exist for more than 6 months.

In a similar fashion, the Corporate Income Tax Act specifies that purchasing, storage, or custody of nonsale assets; advertising; public relations; collection and furnishing of information, market surveys, and other business activities of a preparatory and auxiliary nature, are not taxable.[12] Engagement of another entity for the mere processing of products destined for re-export is also regarded as a liaison

9. "Nonaffiliate transaction" means an arrangement where the liaison office also renders agency or other services for parties abroad that have no equity connection to the head office (or parent) of the liaison office. For example, a liaison office which conducts purchasing activity in Korea may buying for a group of companies in the United States, some of which are under common ownership with it and others which have simply contracted with it.

10. CITA, *supra* note 8.

11. Korea-U.S. Tax Treaty, *supra* note 6, at art. 9(3).

12. CITA, *supra* note 8, at art. 56(4).

activity. Transgressions of these limits bring about tax liability in Korea. For example, the provision of after-sale services is not a liaison activity.[13]

Disputes often arise over the scope of liaison activities when the home office is selling its products to Korean buyers. Basically, the Korean liaison office must not participate in the process of contract negotiation or execution. Under general principles of international taxation, sales profit of an overseas supplier will be taxable in Korea if the supplier has an employee or an agent who regularly exercises the authority to conclude sales contracts on behalf of the supplier.[14] The Korean tax authorities have broadened the concept of contract conclusion, and thus negotiation of the material elements of the contract may subject the entire sales profit to Korean income tax.[15] Even if the final contract is executed by the home office, a permanent establishment will be found (and thus the entire sales profit will be taxable in Korea), if the liaison office employees exercise *de facto* authority to negotiate material terms of the contract, which are then merely rubber-stamped by the home office.[16]

Purchasing activity normally causes no problems. The Korean liaison office may execute purchase agreements on a constant basis. Liaison activity concerning financing, securities, insurance, and management contracts is subject to stricter control by the Ministry of Finance (MOF). Approval for this business is reserved to the MOF.[17]

B. Procedures for Approval/Reporting

Establishment of a liaison office must be approved by (officially "reported to") the Bank of Korea (BOK).[18] In the BOK procedure, no distinction is made between a branch and a liaison office because this distinction has significance only for tax purposes. After the BOK approval, introduction of operating funds must be reported to the BOK within ten (10) days after the close of each calendar quarter. The transfer of funds should be transmitted exclusively through a

13. NTA Ruling of Nov. 26, 1980, WAE IN 1264.37-3543. *See also* OECD Model Commentary 24 on Article 5.
14. OECD Model Taxation Convention on Income and on Capital, art. 5(5)[hereinafter OECD Model Convention]; UN Model Convention, art. 5(5).
15. CITA Enforcement Decree, *supra* note 8, at art. 122(3)(3).
16. *Id.*
17. Foreign Exchange Control Regulation, art. 16-2(2), MOF Notice 361 (Nov. 26, 1964), *as amended by* MOF Notice 88-20 (Oct. 25, 1988) [hereinafter FECR].
18. *Id.* at art. 16-2(1).

particular bank designated by the liaison office. Introduction of funds in excess of $1,000,000 per year is subject to prior approval by the BOK.[19] The BOK advises the relevant tax office of the introduction of the funds.

Unlike a branch or subsidiary, liaison offices need not be registered with the court. If, however, the liaison office is expected to execute purchase agreements continuously for the home office, it would be convenient to register with the court.[20] Liaison representatives then would be able to execute contracts without a power of attorney from the home office. For purposes of court registration, a liaison office is also registered as a branch.[21] A Korean liaison office need not be registered with the tax office, but it may be required to register as an income tax withholding agent for its employees.[22]

C. Individual Income Tax on the Employees

Unless all of the liaison office employees are paid in foreign currency from abroad (class B income), the liaison office must register with the relevant tax office as a withholding agent.[23] The following documents are typically required for this purpose, although practice differs depending upon the relevant tax office:

1) a copy of the BOK approval of branch establishment;
2) a copy of the Articles of Incorporation of the enterprise represented;
3) a copy of the office lease agreement; and
4) a sketch of the office location.

III. Assessing Legal Feasibility of the Intended Business

Korean legal restrictions on foreign operations and investment projects are organized according to the Korean Standard Industrial Classification (KSIC), a functional taxonomy of business lines published by the Economic Planning Board (EPB).[24] The KSIC is based

19. *Id.* at art. 16-4(2).
20. The office should be registered through the district court having jurisdiction over the place where the local office is located.
21. Act Concerning Procedure in Non-Contentious Matters, art. 273, Law No. 1240 (Dec. 29, 1962), *as amended by* Law No. 3724 (Apr. 10, 1984) [hereinafter Act Concerning Non-Contentious Matters]. The required documents are the articles of incorporation, certificates of incorporation and good standing, and an affidavit containing other information. *Id.*
22. NTA Ruling of Dec. 16, 1986, Peobin 2601-3686.
23. R. Baskerville & W. Kim, Tax Management Foreign Income Portfolio-Business Operations in the Republic of Korea § III(A) [hereinafter Baskerville & Kim].
24. EPB Notice 71, last revised Jan. 26, 1984.

on the International Standard Industrial Classification recommended by the United Nations.[25] Accordingly, determination of the relevant KSIC(s) of the intended business is the starting point for analysis of an investment and business opportunity in Korea. All business operations are classified into nine grand categories (under the KSIC), which in turn are subdivided into 1,048 more particular (five digit) classifications.[26]

The legal feasibility of entering into a business in Korea is governed by the Guidelines for Foreign Investment (Investment Guidelines),[27] established pursuant to Articles 7(2), 7(4), and 9 of the FCIA.[28] In general, these Investment Guidelines divide foreign investment opportunities into "open," "prohibited," and "restricted" categories.[29] Foreign investment in a restricted area is not permitted unless the Investment Guidelines (including sub-regulation, "Criteria for Permitting Foreign Investments in Restricted Industries") set forth certain criteria or standards defining the conditions under which foreign investment will be approved.

A. Branch or Subsidiary?

Theoretically speaking, the Investment Guidelines only govern direct equity investment and do not cover branch operations. In this context, direct investments mean any subsidiary organized under Korean law. A foreign entity may, subject to MOF approval, invest in Korea to form a corporate subsidiary under Korean law. As one would expect, the subsidiary is a separate legal entity, in contrast to a branch of a foreign entity which is merely a Korean office of a company incorporated in another jurisdiction.

In the same manner as in most other jurisdictions, Korean law recognizes the formation of a Korean branch of a foreign entity. The branch is not a separate legal entity, but only an extension of the foreign entity itself into Korean territory, subject to BOK approval. For financial institutions, financial brokerages, securities and insurance firms, corporate management businesses, and other similar enterprises, MOF approval is required. Formation of a subsidiary

25. For general information on harmonizing of standards classifications, contact the United Nations Industrial Development Organization (UNIDO).
26. Guidelines for Foreign Investment, art. 1(2), MOF Notice 89-19 (Dec. 30, 1989).
27. MOF Notice 89-19, last revised Dec. 30, 1989.
28. FCIA, *supra* note 3, at arts. 7(2), 7(4).
29. Guidelines for Foreign Investment, arts. 4, 5.

(i.e., a foreign-invested Korean corporation) is regulated by the FCIA and the Korean Commercial Code (KCC), while formation of a branch is regulated by the Foreign Exchange Control Act (FECA) and the Commercial Code.[30]

Establishment of a branch in Korea will result in the submission of the foreign entity to Korean jurisdiction. Under the Commercial Code, a foreign entity having a branch in Korea will be bound by any action (legal or illegal) taken by the branch representative to the extent the counter party acted in good faith.[31] The foreign entity cannot divorce itself from legal responsibility arising out of the contractual breaches, torts, or other misfeasance of the branch. Claims by a third party could reach beyond the branch assets to the overseas assets of the foreign entity. There exists no minimum investment requirement for a branch, but the home office must have paid-in capital of at least $20,000.[32]

A subsidiary (wholly-owned or a joint venture) is an independent entity. Korean law recognizes four types of companies, two of which are limited liability companies. In order to separate the foreign investor from the liability of the subsidiary, the subsidiary must be a stock corporation (*Chusik Hoesa*) or a limited company (*Yuhan Hoesa*). A *Chusik Hoesa* is similar to an *Aktiengesellschaft* under German law or to a *Sociètè Anonyme* under French law. A *Yuhan Hoesa* resembles the G.m.b.H. or S.A.R.L. forms.[33] Within Korea, in contrast to European practice, the vast majority of business entities take the forms of a *Chusik Hoesa* rather than a *Yuhan Hoesa*. Even

30. FECR, *supra* note 17, at arts. 16-1 to -10; KCC, *supra* note 1, at arts. 614-621.

31. KCC, *supra* note 1, at arts. 209, 614.

32. The legal basis for this minimum capital is not clear, but it is required in practice to deter an investment by a shell company.

33. "*Chusik Hoesa*" translates as joint stock company or "company with marketable shares" while "*Yuhan Hoesa*" is translated as "limited company." The difference is basically analogous to the U.S. law distinction between widely held and closed corporations; however many *Chusik Hoesa* are not public in that their shares are held by only a few shareholders, although they could be listed and publicly traded. The German and French analogues are as follows:

	Joint Stock Co.	*Limited Co.*
Korea	*Chusik Hoesa*	*Yuhan Hoesa*
FRG	*Aktiengesellschaft (A.G.)*	*Gesellschaft mit beschränkter Haftung (G.m.b.H.)*
France	*Sociètè Anonyme (S.A.)*	*Sociètè à responsabilitè limitèe (S.A.R.L.)*

See 1 INT'L ENCYCLOPEDIA COMP. L., at F-16, F-74 (V. Knapp ed. 1974).

relatively small enterprises use the former structure, which requires a minimum equity capital of only W50,000,000.[34]

The *Chusik Hoesa* vehicle is generally regarded as more prestigious. In some instances, however, a *Yuhan Hoesa* may be an advantageous form for foreign investment because of characteristics peculiar to a closed company. In a *Yuhan Hoesa*, the unilateral transfer of shares by a shareholder (more precisely a "member") may be blocked by inserting language to such effect in the articles of incorporation.[35] If the articles of incorporation are silent, a share transfer may be conducted only after three fourths of the total shareholders consent.[36] In a *Chusik Hoesa*, by contrast, transfer of shares may not be restricted in the articles of incorporation, although a shareholder who violates transfer conditions in a joint venture agreement will be liable to the other shareholders for damages.[37]

Another advantage is that resolutions by written consent are allowed for board meetings of a *Yuhan Hoesa*, while the directors of a *Chusik Hoesa* must always participate in the board meetings in person.[38] One significant disadvantage of a *Yuhan Hoesa* is that it may not issue bonds or debentures to raise debt capital.[39]

A subsidiary may not be established by the acquisition of existing shares owned by a domestic Korean shareholder. Foreign investors may subscribe for newly issued shares, but they may not purchase outstanding shares.[40] Under the FECA, the Korean capital market is not yet open to foreign investors.[41] Consequently, neither direct investment nor acquisition on the market of a controlling interest in existing companies is possible at present, though changes are expected

34. The current exchange rate is approximately U.S.$1 = Won 700, so W50 million is roughly U.S.$71,500. However, a foreign-invested entity is subject under the FCIA to the minimum investment requirement of U.S$100,000, of which the excess over W50,000,000 may be contributed after incorporation. *See* FCIA, *supra* note 3, at art. 11.

35. KCC, *supra* note 1, at art. 556(1).

36. *Id.* at art. 556(2).

37. *Id.* at arts. 335(1), 390.

38. *Compare id.* at art. 564 (corporate decision) *with id.* at art. 391 (method of resolution for *Chusik Hoesa*). Allowability of resolutions by written consent (also called "circular resolution") in a *Yuhan Hoesa* is not expressly specified in Article 564 of the Korean Civil Code, but is generally recognized in civil law countries.

39. *Id.* at arts. 469-516. The debenture issuance authority defined in Articles 469-516 for the *Chusik Hoesa* form has no correlate in the provisions on capitalization of the *Yuhan Hoesa* form.

40. FECA, *supra* note 2, at art. 24, In reality, this restriction is a governmental policy rather than a purely legal issue because the FECA (including sub-regulations) allows the Minister of Finance to waive the restriction. As described in the text, international financial organizations actually purchased existing shares.

41. *Id.*

in these restrictions.[42] Some international financial organizations (for example, the World Bank, the International Finance Corporation, and the Asian Development Bank) have been allowed to purchase shares in Korean financial institutions from domestic shareholders for national development projects. This exception, however, has not been extended to private foreign investments.

Thus, formation of a subsidiary must be accomplished either by incorporating a new company or by subscribing for additional shares newly issued by a domestic corporation, pursuant to the FCIA. To form a 100 percent subsidiary, no other choice exists but to incorporate a new company. To form a joint venture company, the foreign investor may incorporate a new company in cooperation with a local partner, or invest in an existing company owned by the local partner. The minimum amount of a foreign investment for a joint venture company is $100,000.[43]

Each of the two alternatives, branch and subsidiary, have advantages and disadvantages. Basically, limitations on liability exposure, minimum investment requirements, and the dividend tax are the most important distinctions between the two. Some of these points will be discussed below in the relevant sections covering the legal environment for foreign investment.

Although the Investment Guidelines apply by their terms only to formation of subsidiaries and joint ventures, the FECA also refers to the same standards.[44] Thus, a branch form of investment is not possible if the business belongs to the prohibited categories under the Investment Guidelines. Establishment of a branch in a line of business falling within the open or restricted categories of the Investment Guidelines is subject to the discretion of the competent ministry. In theory, the BOK has sole authority over the authorization of branch establishments, but in practice unprecedented applications are acted upon in close consultation with one or more concerned ministries. Apart from precedents of approval and the internal policy

42. At present, indirect portfolio investment is possible through a number of trust vehicles, and direct portfolio investment will be possible in the near future. According to a recent report: "The government is cautiously considering allowing foreigners to take over existing Korean corporations by acquiring their equity shares, although not through the stock market according to the Finance Ministry." Korean Econ. J., Mar. 5, 1990, at 1, col. 2. Article 2 of the OECD Code of Liberalization of Capital Movements requires full liberalization of direct investment. Ultimately, Korea expects to become a member of the OECD.

43. *See* Guidelines for Foreign Investment, *supra* note 26, at art. 3. For a small project entailing technology transfer, the minimum investment is U.S.$50,000.

44. FECR, *supra* note 17, at art. 16-3(1), (3).

guidelines of the relevant ministries and the BOK, no express legal statute or regulation governs establishment of branches in a business classified as "open" or "restricted" under the Investment Guidelines.

To summarize, 1) some businesses are closed to foreign investors irrespective of the form of investment; 2) some businesses are open to a subsidiary but not to a branch form of investment; 3) a few businesses are open to a branch but not to a subsidiary form of investment; and 4) some businesses are open to branches as well as subsidiaries. A choice between a branch and a subsidiary is meaningful only in this last situation. Basically, branches are not allowed to conduct manufacturing operations in Korea, and most branches are engaged in such activities as financial services, local distribution, engineering, supervision, agency, or other services. While a Korean manufacturing base must take the form of a subsidiary, marketing is accessible to subsidiaries as well as branches, though different restrictions apply to the two categories. The present analysis will be confined to the establishment of a local sales presence and a local manufacturing base.

IV. Legal Feasibility of Local Sales Presence

A. Investment Opportunity

Under current Korean law and policies, substantially all non-retail distribution activities are open to a foreign investor without substantial restrictions. Under the recently adopted "negative list system", a subsidiary or branch in Korea may import and distribute any commodity except those enumerated in the negative list.[45] Under the new Investment Guidelines, the Criteria for Permitting Foreign Investments in Restricted Industries and the Ministry of Trade and Industry (MTI) policy, even a 100 percent subsidiary or a branch may freely engage in the trading business, subject to approval by the MOF, BOK, and licensing by the MTI.[46]

After obtaining the MOF/BOK approval and the MTI license, the subsidiary or branch may: enter into an importation agreement to purchase merchandise from its overseas sister companies (or other sources), open letters of credit in favor of overseas suppliers, effect

45. Guidelines for Foreign Investment, *supra* note 26, at arts., 4, 5. *See infra* note 47 and accompanying text.
46. FTA, *supra* note 4, at art. 7(2).

customs clearance of the imported merchandise, stock the goods in its own warehouse and sell the merchandise on a wholesale basis. In sum, the subsidiary or branch will be freely allowed to conduct trading and local distribution activities, subject to the following restrictions.

1. The foreign-invested subsidiary or branch may not be involved in the import or distribution of negative list items. These are:[47]

KSIC	*Description*
61111	Grains
61112	Meats
61113	Seafood
61114	Fruits and Vegetables
61115	Breads and Cookies
61116	Nonalcoholic beverages (open to a subsidiary)
61117	Alcoholic beverages
61118	Prepared foods
61119	Farm products, foods and beverages not elsewhere classified
61134	Fertilizers
61135	Pesticides
61161	Lumber (open to a subsidiary)
61191	Books and newspapers

2. Distribution activities by a subsidiary or branch are confined to those which are wholesale in nature. A subsidiary may conduct retail activity in a strictly limited fashion, *i.e.*, by owning and operating one (1) retail shop of 700 square meters or less in area.[48] A branch may not participate in the retail business in any manner. Except for last stage retail activities, a subsidiary or branch may establish its own distribution channels in Korea.

3. A subsidiary may import commodities from any source around the world. In the case of branches, the sources of imported products are still limited, but amendments to applicable rules have expanded the allowable import source to include 30 percent affiliates.[49] In other words, a Korean branch may only import products manufactured by a foreign affiliate which owns 30 percent or more of the home office or is 30 percent or more owned by the home office.

---

47. Guidelines for Foreign Investment, *supra* note 26, at attachment 1 (prohibited projects), and attachment 2 (restricted projects).
48. *See id.* at art. 6.
49. The legal basis for this 30% ownership is not clear.

> The scope of this definition of an affiliate may be further expanded by MTI on a case-by-case basis if necessary.[50]

To the extent that the imported products are manufactured by a 30 percent affiliate, the Korean sales presence may take the form of either a subsidiary or a branch. This branch or subsidiary will be allowed to import, warehouse, and supply the products in Korea. Application for foreign investment under this new measure will have to pass governmental review and will be subject to the discretion of the governmental authorities, because the new regulation specifies that "the possibility of excessive competition or infringement on the business of the local entities must be reviewed before approval."[51]

B. Investment Vehicle for Sales Presence

As indicated in the preceding section, the Korean sales presence of a foreign enterprise may take the form of 1) a local subsidiary; 2) a branch of an affiliate of the overseas manufacturer; or 3) a branch of the overseas manufacturer itself. In alternatives 1) and 2), the local presence is a distinct legal entity, and in alternative 3) the local presence is a mere Korean extension of the overseas manufacturer. If a foreign marketing affiliate which performs the role of an exclusive or non-exclusive distributor for the Korean market on behalf of the manufacturer exists, the local presence may be established as a branch of the marketing affiliate rather than of the manufacturer. In alternatives 1) and 2) the local subsidiary or branch will be contractually connected with the overseas manufacturer or marketing affiliate, because the local subsidiary or branch is a separate entity from the overseas supplier.

In alternative 2), involving a Korean branch of the overseas manufacturer or marketing affiliate, no sales agreement can be executed between the Korean presence and the overseas manufacturer, since transfers between them occur on an intra-firm basis. In this event, in theory, the manufacturer or marketing affiliate would ship the products to its Korean branch, the Korean branch will sell the products in the local market, and the sales proceeds will be remitted to the overseas head office. In reality, however, this arrangement is not feasible because Korean exchange control authorities do not allow

---

50. FTA E.D., art. 8(2)(d), Presidential Decree of June 29, 1987, *as amended by* Presidential Decree 12949 (Mar. 8, 1990) [hereinafter the FTA E.D.].

51. Guidelines for Foreign Investment, *supra* note 26, at attachment 4.

import relationships on a simple consignment sale basis.[52] If a Korean branch of an overseas seller intends to import products from its head office, the branch must execute an international sales agreement with its head office (an abnormal document in terms of contract law) and settle payments on a letter of credit or documents against payment basis. Usance letters of credit or installment payments are normally not allowed for import settlements.[53]

Restrictions of this nature eliminate significant advantages of establishing a local presence in the form of a branch of the overseas manufacturer. Consequently, foreign suppliers usually establish their Korean sales presence in the form of a local subsidiary or a branch of an affiliate, rather than as a branch of the exporting firm. Further, if the Korean sales presence takes the form of a branch of the overseas supplier, many activities of the foreign supplier could be exposed to Korean tax liability. Thus, unless the law of the foreign supplier's home jurisdiction so requires, a Korean presence is usually not established as a branch of the foreign supplier itself.

C. *Trading License*

Before engaging in the import of commodities, a foreign-invested subsidiary or branch must also obtain a trading license as required under the Foreign Trade Act (FTA).[54] Under the FTA, only holders of a trading license may export or import goods. Without such a license, a consignee must hire a licensed trader who will conduct the export/import operations on its behalf. As already indicated, foreign-invested subsidiaries or branches may obtain this license, but only upon satisfaction of the FTA requirements. Even without this license, a sales subsidiary may distribute in Korea by hiring a licensed trader, but it is usually advisable to obtain the trading license, since preconditions for licensing have been eased somewhat in recent years.

The FTA creates two categories of trading licenses, class A and class B.[55] Class A licenses permit the holders to engage in general foreign trade, while class B licenses are not applicable to trading subsidiaries. The class A license requirements are:

52. FECR, *supra* note 17, at arts. 9-4(5), 9-9. Under these rules, consignment sales (other than periodicals) must be approved by the BOK. Currently, the BOK does not approve it.
53. *Id.* at arts. 9-4, 9-11 to -19.
54. FTA, *supra* note 4, at art. 7.
55. FTA E.D., *supra* note 50, at art. 6.

minimum paid-in capital of 50 million Won; (which is overridden by the FCIA minimum equity investment of U.S. $100,000);[56] and the annual volume of exports and imports must not fall below U.S. $500,000 for two consecutive years or the license will lapse.

A branch form of a sales company must also obtain a trading license. Branches are not eligible for class A licenses, and can only obtain a class B trading license, which includes all trading licenses other than a general, unrestricted class A license. Several subcategories are encompassed by the class B license. No special substantive requirements apply to class B licenses sought by branches. There are no minimum capital or trade volume requirements, and the foreign branch usually can obtain a class B license merely upon application, provided that the branch is engaged only in importing commodities manufactured by its home office or its affiliates.[57]

D. *Offer Agency License*

In addition to the trading license, a local sales subsidiary or branch which intends to conduct autonomous marketing activity may need to obtain a "class A trade agent" license, commonly known in Korea as an "offer agency" license.[58]

An offer agency is a form of local sales activity which may or may not be coupled with a distributorship in the form of a subsidiary or branch. In Korea, most local agents do not stock foreign products and thus do not take title to the goods; they only represent the foreign supplier for the purpose of concluding international sales contracts. A foreign supplier may, with a minimum investment, establish a local presence limited to this agency function, or it may couple this function with a regular sales presence importing, warehousing, and selling the goods to local buyers. In an offer agency arrangement, the local buyer imports products directly from the overseas supplier after execution of a sales agreement between the buyer and the seller.

The legal status of offer agencies reflects the special Korean regime linking exchange control to import administration.[59] In the Korean

56. *See supra* note 34.
57. FTA E.D., *supra* note 50, at art. 8(2)(d).
58. *See* S. H. SONG, AN INTRODUCTION TO THE LAW AND LEGAL SYSTEM OF KOREA 575-76 (1983) [hereinafter SONG].
59. *See generally* LEE & CALLAWAY, FOREIGN EXCHANGE CONTROLS IN KOREA AND THEIR IMPACT ON INTERNATIONAL COMMERCIAL TRANSACTIONS, BUSINESS LAWS IN KOREA: INVESTMENT, TAXATION AND INDUSTRIAL PROPERTY 246 (C.J. Kim 2d ed. 1988).

trading system, all import contracts must in principle be concluded on the basis of a "firm offer sheet." The term "firm offer sheet" means a prescribed document representing the supplier's irrevocable offer to sell goods to the domestic buyer. Such a firm offer sheet is normally required to obtain import approval from an authorized bank, although the FTA does provide for approval of import agreements in several other exceptional circumstances.[60] This firm offer sheet must be issued by a licensed offer agent, *i.e.*, a class A trading agent. An offer agency presence of a foreign supplier is an efficient vehicle for local distribution with a minimum investment in Korea. Moreover, an offer agency presence is often possible even if a regular sales presence is prohibited under Korean law.

E. Alternatives for Presence Limited to Offer Agency

The offer agency business is open to branch as well as subsidiary forms of investment, which are governed by the FECA and the FICA, respectively, as well as by generally applicable FTA provisions.[61] The MOF Investment Guidelines classify offer agency business under KSIC 61320, which is a restricted area for foreign investment.[62] However, the sub-regulation "Criteria for Permitting Foreign Investments in Restricted Industries," specifies that the local offer agency business is open to a subsidiary form of foreign investment, upon fulfillment of the requirements laid down in Article 14 of the FTA.

Establishment of offer agencies as branches of foreign firms is not expressly addressed in the statutes or the regulations. Internal policies of the MTI and the BOK and pertinent precedents furnish some guidance, however. In recent practice, the BOK has approved the establishment of offer agency branches without any special restriction, subject to FTA requirements. Previously, offer agency branches were only allowed to conduct transactions between the head office and the Korean buyer. This restriction has been relaxed. The offer agency branch may be established as a branch of the overseas supplier itself or as a branch of an affiliate of the supplier, although foreign investors generally take the latter approach for tax and other reasons mentioned below.

60. Foreign Trade Control Regulation, arts. 3-1-2, -4, Ministry of Trade and Industry Notice 87-17 (June 30, 1987), *as amended by* Notice 89-28 (Aug. 7, 1989) [hereinafter FTCR].
61. FTA, *supra* note 4, at arts. 14-17.
62. Guidelines for Foreign Investment, *supra* note 26, at attachment 2.

F. Licensing Requirements

Under the FTA, grant of a class A trading agency license requires membership in the Korean Trade Agents Association. This is possible upon fulfillment of two conditions. First, the agent must represent at least one overseas supplier.[63] Second, for the maintenance of the license, an offer agent must earn minimum commissions of U.S. $30,000 annually.[64] This requirement also applies to a foreign branch offer agency. However, these two conditions do not apply if the offer agency is established as a branch of the overseas supplier itself. These requirements raise certain tax considerations discussed hereafter.

G. Scope of Functions of Offer Agent

After formation of a branch or subsidiary which acts as an offer agent, the branch or subsidiary may seek out potential buyers and enter into sales agreements on behalf of the overseas supplier as its principal. In general, no restriction exists on the scope of potential purchasers, so that an offer agent branch or subsidiary may offer the sale of the principal's product to any entity or individual in Korea.

In case the local agent branch or subsidiary in Korea offers a product to a Korean entity holding a trading license, the buyer will arrange for import of the offered product. The procedures typically involve obtaining any necessary trade association recommendation, procuring bank approval for the payment, opening a letter of credit, and seeing to customs clearance after arrival of the product. All these procedures will be rendered by the importer in its own name. The offer agent branch or subsidiary may also offer the product to an entity or individual who does not possess an import license. In this case, the buyer will have to entrust the import procedures to a licensed importer and pay a commission for the importer's service.[65]

In availing itself of the offer agency arrangement, three alternatives are available to an overseas supplier. First, the offer agency business

63. FTA E.D., *supra* note 50, at art. 19(1). Previously, an agent had to represent at least two overseas suppliers, of which one had to be located in a non-Asian region. In the last revision of the FTA E.D., dated March 8, 1990, this requirement was repealed.

64. *Id.* at art. 23.

65. The requirement of a trading license under Article 7(1) of the FTA, implies this, unless an exemption is applicable under Article 9 of the FTA which covers imports by public and non-profit organizations. FTA, *supra* note 4, at arts. 7(1), 9.

may be conducted by a local subsidiary incorporated under Korean law. Second, an offer agency entity may be established as a branch of an entity other than the overseas supplier. Third, an offer agency branch may be established as a branch of the overseas supplier itself. In the first or second alternative, the subsidiary or the branch is an agent in the legal sense, working on behalf of the overseas supplier as the principal. In the third alternative, where the branch is involved in a transaction between its home office and a Korean buyer, the branch is not an agent of the home office in the legal sense because the branch is only an extension of the same entity. Korean law requires that a firm offer sheet be issued whether or not the home office is involved in the transaction.[66]

When the local offer agent is an entity distinct from the overseas supplier, the authority of the offer agent depends upon written authorization given by the overseas principal at its discretion. The FTA and the FECA impose no special restrictions in this regard. No exclusivity requirement exists. The commission rate, choice of law, place and procedure of arbitration, and other contents of the agency contract may be freely determined by the parties.[67]

The content of an agency agreement is not subject to review or approval by the Korean Trade Agents Association at the time of registration. Accordingly, the authority of the offer agent operating under a class A trade agent's license may span a broad range of activities, depending on the authorization given by the overseas supplier. The offer agent may at its maximum seek potential buyers, negotiate the terms and conditions of the sale and purchase contract, and issue the firm offer sheet to the buyer in order to define and substantiate the terms of the agreement between the overseas supplier and the Korean buyer.

At the other extreme, the authority of the offer agent may be limited to simply conveying the seller's offers to the buyer under the agent's name, thereby satisfying the formal FTA requirement of issuance of a firm offer sheet.[68] The authority of the offer agent also may be limited in terms of the monetary amount and nature of

66. The approval required under Article 19 of the presupposes that the terms of settlement and other contract terms have been documented. FTA E.D., *supra* note 50, at art. 25; FTCR, *supra* note 60, at art. 3-1-2.

67. Party autonomy is the general principle under Korean substantive law (KCC) as well as the Conflict of Laws Act, arts. 9, 10(2), Law No. 966 of Jan. 15, 1962 (subject to public policy exceptions).

68. FTCR, *supra* note 60, at art. 3-1-4.

transaction. Nevertheless, it should be noted that the general agency theory of "apparent authority" will also apply to an offer agency. In principle, therefore, the overseas supplier may be legally bound by an action of the agent which exceeds the authority vested, if the action is determined to have been within the sphere of apparent authority.

In the third alternative, forming a local agent entity as a branch of the overseas supplier itself, the overseas supplier will, of course, be immediately bound by branch activities subject to general contract law principles laid down in the Civil Code and Commercial Code.[69]

V. Permanent Establishment Issues

If an overseas supplier intends to establish an offer agency presence in Korea, attention should be paid to the potential Korean income tax exposure of the overseas supplier.

Under the internationally accepted general principle of permanent establishment,[70] the business profits a foreign supplier derives from offshore sales of goods to Korean buyers are subject to the corporate income tax of Korea only if the selling corporation has a permanent establishment in Korea.[71] Even without a fixed place of business, an overseas supplier is deemed to have a dependent agency type of permanent establishment if a person in Korea habitually exercises authority to enter into contracts in the name of the foreign enterprise.[72] A person who negotiates all elements and details of a contract in a way binding on the supplier is regarded to have this authority.[73] The Ministry of Finance and the National Tax Administration, two Korean tax authorities, interpret this criterion somewhat expansively, and the negotiation of material elements of sales agreements is held to constitute "doing business" at a level warranting a finding of a permanent establishment.[74]

Under the interpretation of the concept of permanent establishment adopted by the Korean tax authorities of late, an overseas supplier

69. *See supra* note 31.

70. The term "permanent establishment" is defined as a fixed place of business through which the business of an enterprise is carried out. OECD Model Convention, *supra* note 14, at art. 5(1).

71. *Id.* at art. 7(1).

72. *Id.* at art. 5(5). "Dependent agency" refers to a controlled agent acting only on behalf of the controlling principal. *Id.*

73. *See id.* at commentary on art. 5.

74. CITA Enforcement Decree, *supra* note 8, at art. 123(1)(3).

will be deemed to have a permanent establishment if the offer agency entity is established as a branch of the supplier itself. Under such circumstances, the total profit from sales to Korea will be taxable in Korea.[75] Of course, this Korean tax may be creditable in the payment of home country income tax, under the foreign tax credit or foreign income exemption provisions.[76]

In the event that the offer agency is established as a local subsidiary or a branch of an affiliate other than the supplier, it is possible to avoid a permanent establishment characterization and the corresponding tax liability, because in such cases the Korean presence is subject to tax only on its commissions. This alternative does not necessarily solve the problem, however, because the very definition of the role of an offer agent is to issue a firm offer on behalf of overseas suppliers, which is tantamount to the formation of a contract because the offer is irrevocable. Despite the fact that the offer agent is a distinct entity, the tax authorities may adopt a "substance over form" approach and characterize the Korean agency as a permanent establishment of the seller. To minimize this risk, the offer agent subsidiary or branch should not be authorized to negotiate the elements of the supply contract on behalf of the principal. The agency contract between the agent and the supplier should be carefully drafted to provide an explicit denial of such authority.

As previously noted, the offer agency function may be combined with regular distribution from stock in a single entity. Here, also, the option of forming a branch of the overseas supplier itself is unattractive for tax reasons. The two remaining options are: 1) forming a local subsidiary, or 2) forming a branch of an affiliate of the overseas supplier. In either case, to the extent that the two functions are combined in a single entity, the branch or subsidiary will be a permanent establishment and will have to pay Korean income tax on the entire profit from Korean sales.[77] If the Korean presence performs the role of a local distributor for the overseas supplier and also the role of an offer agency for the supplier, the Korean tax authorities will attempt to tax not only the agency commissions, but also the entire Korean sales profits of the supplier.

To limit tax exposure, the foreign enterprise may divide the two functions and form two separate entities. This approach presupposes

75. NTA Ruling 6-1-19, art. 55.
76. *See* OECD Model Convention, *supra* note 14, at commentary on art. 23.
77. Many Japanese sales presences are taxed in this fashion, although the difference between the Japanese and the United States taxation treaties could affect the taxability.

that the two entities will actually be managed independently. If the two entities are in reality one, that is, if the two entities are located in the same office and share employees or overhead expenses, the Korean tax authorities may disregard the legal distinction between the two entities.[78] Imputed sales profits arising from Korean sales for which the offer agent intervened would be taxed. The split entity approach is a viable one only where the tax savings would justify the logistical inconvenience of maintaining distinct operations and staffs. In that case, the offer agency presence will be taxed only on its commission income, and the supplier's profits earned from the Korean sales will not be taxable in Korea.[79]

VI. Legal Feasibility of Local Manufacture Prohibited and Restricted Activities

While most local manufacturing activities presently are open to foreign investors, the following sectors are closed: the manufacturing of tobacco products, the publication of newspapers, periodical magazines or books, and printing activity.[80] In addition, the following businesses are restricted: the slaughtering of livestock or poultry, involvement with ginseng products (except tea, tablet and powder), tobacco stemming and redrying, commercial printing by stencil paper, the manufacture of biological products, and the manufacture of explosives and pyrotechnic products.[81] Manufacturing projects entailing unacceptable levels of environmental pollution are subject to restriction.[82] Environmental impact is assessed on a case-by-case basis. Several significant projects have been suspended or rejected in the past several years due to pollution concerns.[83]

The Investment Guidelines set forth the following standards for review of investment proposals in biological manufacturing:

1) Foreign-invested biological manufacturing companies must produce final pharmaceutical products (including synthesis of the ther-

78. CITA, *supra* note 8, at art. 20.
79. MOF Ruling of Mar. 26, 1980, Kukjo 1260.1-842; NTA Ruling, Kugil 22601-554.
80. Guidelines for Foreign Investment, *supra* note 26, at arts. 4, 5.
81. Among restricted businesses, the manufacture of biological products (KSIC 35221), which does not include pharmaceutical products, is accessible to foreign investors, with the exception of blood preparation.
82. The Ministry of Hygiene and Social Affairs control is affected on a case-by-case basis, though Article 9 of the FCIA demands prior notice of the restricted activities. FCIA, *supra* note 3, at art. 9.
83. *See* Asian Wall St. J., Jan. 2, 1990 (discussing titanium-dioxide project applied for by Du Pont).

apeutic substance), which are needed in the domestic market.[84]
2) In principle, the foreign shareholding ratio cannot exceed 50 percent. An initial foreign equity ratio of up to 70 percent may be allowed on the condition that the ratio is lowered to 50 percent or less within five years after government approval of the foreign investment.[85] If the foreign-invested company manufactures basic products requiring sophisticated technology, 100 percent foreign shareholding may be allowed on an exceptional basis.
3) The scope of local manufacture in the biological manufacturing sector is confined to products developed by the foreign investor or its affiliate (including licensed products) which are already being manufactured and sold in the foreign investor's home country after having passed relevant effectiveness/safety tests.[86]
4) Certain items listed in the protection list designated by the Ministry of Health and Social Affairs under Article 72-4 of the Pharmaceutical Act cannot be manufactured by foreign-invested enterprises.[87]

A. Protection of Small and Medium Industry

Except for the restrictions mentioned above, manufacturing activities are open to foreign investment. Nevertheless, there is one additional restriction that might apply to a multinational foreign investor. A number of manufacturing activities have been reserved to smaller companies. Where these restrictions apply, not only foreign investment, but investment by major Korean conglomerates also is prohibited.

The Investment Guidelines limit access to certain manufacturing activities in accordance with the policy of promoting small and medium enterprises (SME).[88] The SME Basic Act defines SME by 1) the amount of total assets and 2) the number of employees.[89] To qualify as an SME, both criteria must be satisfied. For example, as pertaining to KSIC 38269 (Manufacture of Service Industry Machinery Not Classified Elsewhere), the first criterion is that the total assets may not exceed W20,000,000,000 and the second criterion is that the number of employees may not exceed 300.[90]

---

84. Criteria for Permitting Foreign Investment in Restricted Industries.
85. *Id.*
86. *Id.*
87. *Id.*
88. Guidelines for Foreign Investment, *supra* note 26, at art. 8.
89. SME Basic Act Enforcement Decree, art. 2, Presidential Decree 11200 (Aug. 11, 1983), *as amended by* Presidential Decree 12336 (Dec. 31, 1987).
90. *Id.*

There are two types of restrictions on foreign investment in connection with the SME: (1) some businesses are classified as SME-Exclusive Businesses under the SME Business Coordination Act and (2) some businesses are classified as SME Alignment Items under the SME Alignment Promotion Act.[91] For an SME-Exclusive Business, if the foreign investor is a large sized foreign entity, it will only be allowed to invest with an SME joint venture partner or in an existing domestic SME. In either case, the foreign equity must not exceed 50 percent.[92] Large sized foreign enterprises may invest in SMEs on a larger scale only after going through an extremely rigorous reporting and approval procedure under the SME Business Coordination Act.[93] Up to now, such approval has rarely, if ever, been forthcoming because of the business and political issues involved in protection of existing SMEs. Consequently, attempts to obtain approval under this provision may prove to be fruitless, frustrating, and expensive.

If the foreign investor desires to conduct an SME Alignment business, it must either invest in an SME or participate in a joint venture with a Korean partner who already has received approval to manufacture the item on a large enterprise scale. These restrictions may be negotiable if the foreign investor can demonstrate that it can provide materials or a manufacturing process not otherwise available in connection with the intended manufacture.

B. Protection of New Domestic Technology

Under article 8-2 of the Technology Development Promotion Act, the Ministry of Science and Technology may enforce several measures to protect a new manufacturing technology developed by a Korean enterprise.[94] Under these measures, foreign investment or foreign technology inducement involving a product which is the same as or competitive with the protected product may be temporarily prohibited

---

91. Law No. 2841 (Dec. 31, 1975), *as amended by* Law No. 3651 (Dec. 31, 1982).

92. Guidelines for Foreign Investment, *supra* note 26, at art. 8.

93. SME Business Coordination Act, art. 7, Law No. 3127 (Dec. 5, 1978), *as amended by* Law No. 3832 (May 12, 1986). Under the SME Business Corporation Act, the applicant (large enterprise including large foreign entities) must report the intention to participate in the SME exclusive business, two (2) months in advance to the Ministry of Trade and Industry (the "MTI"). The MTI will prohibit such participation if it is likely that consumer interests or the interests of related business entities will be harmed. If such interests are not likely to be harmed, still the MTI may deny access to the SME exclusive business on a permanent or temporary basis. Typically, the MTI requests opinions from existing SMEs, quasi-government organizations for protection of SMEs, and the organization of SMEs.

94. Technology Development Promotion Act, Law No. 2399 (Dec. 28, 1972), *as amended by* Law No. 4184 (Dec. 30, 1989).

for up to five years.[95] As of June 30, 1989, sixteen products were covered under this measure.[96]

C. *Other Joint Venture Requirements*

Under Article 7(2) of the Investment Guidelines, foreign investment in the following activities will be allowed only when the foreign investor participates in a joint venture with an existing domestic manufacturer engaged in that business:

D. *Industry*

1) Manufacture of cultivators, tractors, rice planters, binders, combines and sprayers;
2) Manufacture of textile fabrics;
3) Manufacture of vegetable oils and fats, husking and milling cereals, manufacture of beans and similar products, and manufacture of starches;
4) Distilling of ethyl alcohol, manufacture of *soju*, ginseng wine, and cheongjoo; and
5) Petroleum refining (foreign shareholding must be less than 50 percent).[97]

VII. Corporate Law and the Joint Venture Agreement

If a foreign investor incorporates a wholly-owned subsidiary in Korea, the significance of Korean corporate law in the operation of

---

95. Technology Development Promotion Act, *supra* note 94, at art. 8-2.
96. The protection measures are occasionally published by the Ministry of Science and Technology. The 16 products are:
(1) Hydrogen Sulfide Absorbent
(2) Propyleneglycolester Alginate
(3) Pin-type Lithium Carbon Fluoride Cell
(4) Industrial Load Cell
(5) Induction Tube for Vein
(6) Molybdenum Wire or Plate
(7) PVDC Shrinkable Film
(8) Super High Pressure Water Flow Cut Device
(9) Photosensitive Resin for PS Plate
(10) Ceramic Antenna and Cathode
(11) Anchor of SEEE Cable
(12) Freon-11 (CC13F)
(13) Dynamite Blaster
(14) Integral Pattern of Aluminum
(15) Modified Polyolefin Seed
(16) Zeolite 4A for Synthetic Detergent
97. Petroleum Business Act, art. 6, Law No. 2780 (July 25, 1975), *as amended by* Law No. 3839 (May 12, 1986).

the company would be greatly reduced.[98] In the event of a joint venture with a Korean company, on the other hand, intricate knowledge of Korean corporation law will be required for negotiation of the joint venture agreement and trouble-free operation of the resulting enterprise. In what follows, some essential Commercial Code provisions concerning the organization and function of a *Chusik Hoesa* are discussed, along with legal requirements applicable to an international joint venture agreement under the Monopoly Regulation and Fair Trade Act.[99]

A. Incorporation

Seven promoters are required for the incorporation procedure, which involves the execution of the articles of incorporation and other documentation.[100] In practice, a third shareholder may be involved in a joint venture to simplify the incorporation procedure and to avoid court review.[101] In the event of a joint venture, the two shareholders become promoters in addition to other individual promoters, who transfer their shares to the joint venture parties immediately after incorporation. The whole incorporation procedure can be completed within one week. The minimum capital amount is W50,000,000 but this requirement is superseded by the FCIA minimum investment of U.S.$100,000 for foreign investors.[102] Any subscribed capital over W40,000,000 may be contributed after incorporation formalities are done. Completion of the incorporation is evidenced by a registration of the company with the local court.[103]

B. Shares

Par value of each share must be denominated in Won currency and be W5,000 or more. "No par value" shares are not permitted. Shares may be in nominative or bearer form, however joint venture companies usually issue nominative shares. Common shares must carry voting rights.[104] Voting rights of preferred shares may be

98. *See* SONG, *supra* note 58, at 828-69 (1983).
99. FAIR TRADE ACT, *supra* note 5, at art. 32.
100. Act Concerning Non-Contentious Matters, *supra* note 21, at art. 249. The documents include several resolutions of the shareholders and board of directors, and a bank certificate of capital subscription and payment. *Id.*
101. KCC, *supra* note 1, at arts. 298-300.
102. *See supra* note 24.
103. KCC, *supra* note 1, at art. 317.
104. *Id.* at art. 369.

restricted in the articles of incorporation.[105] Preferred shares may be participating or non-participating, and cumulative or non-cumulative. Non-voting preferred stock may not exceed one fourth of the total issued and outstanding shares.[106] Convertible shares, convertible bonds, and redeemable shares may be issued.[107]

C. Shareholder Meetings/Shareholder Ratio

A shareholder meeting must be convened at least once a year to approve the financial statements and declare dividends.[108] The election of directors and auditors, remuneration for directors and auditors, approval of transactions between the company and a director or an auditor, amendments of the articles of incorporation, appointment of an independent auditor (CPA firm), and a number of other items must be determined by resolution of a shareholder meeting.[109] The articles of incorporation may reserve any issue to the authority of the shareholders.

Sometimes a foreign investor may hold a minority equity position due to legal restrictions or a business decision. One device available to a minority shareholder is to require that all important decisions be subject to a supermajority approval by the shareholders. This reservation can be effected by an express provision in the articles of incorporation. Without such a provision, a minority shareholder possesses veto power on the following matters, if and only if the minority shareholder owns more than one third of the outstanding voting shares:[110]

1) Amendments to the articles of incorporation, including the company's objects, trade name, authorized capital, par value of shares, number of shares contributed by each shareholder, head office, restriction of preemptive rights to new shares, etc.;
2) transfer of the business or of major assets;
3) conclusion, alteration or termination of a management agreement or profit sharing agreement;
4) purchase of the entire business of another company;

105. *Id.* at art. 370(1).
106. *Id.* at art. 370(2).
107. *Id.* at arts. 344-346, 513.
108. KCC, *supra* note 1, at art. 449(1).
109. *Id.* at arts. 382, 409, 388, 415, 397, 433. *See also* Law on External Auditing for Stock Corporations, art. 4, Law No. 3297 (Dec. 31, 1980), *as amended by* Law No. 4168 (Dec. 30, 1989)[hereinafter Law on External Auditing].
110. KCC, *supra* note 1, at arts. 175(2), 374, 375, 385(1), 400, 415, 434, 438(1), 518, 519, 522(3), 604.

5) agreement to purchase within two (2) years after incorporation assets which were already existing at the time of incorporation and whose value is five percent or more of the capital (Nachgruendung);
6) involuntary dismissal of a director or auditor;
7) discounted issuance of new shares;
8) capital reductions;
10) consolidation with or merger into another company; appointment of consolidation promoter;
11) dissolution of the company or subsequent resumption;
12) conversion of the company into a *Yuhan Hoesa* (unanimous resolution required); and
13) exoneration of a director or auditor from legal responsibility (unanimous resolution required).

Beyond this veto power in the general shareholder meeting, a minority shareholder will have the following rights if the shareholder holds at least five percent of the company's shares:[111]

1) the right to demand the convening of a general meeting of shareholders;
2) the right to request a prohibitory injunction to stop a director's or liquidator's illegal act;
3) the right to institute a derivative action to enforce a director's, an auditor's, or a liquidator's liability to the company;
4) the right to inspect the books of account and documents of the company;
5) the right to inspect the company business and the status of the company property; and
6) the right to demand that the court remove a director, an auditor, or a liquidator.

A shareholder who holds shares representing not less than 10 percent of the total number of the issues shares may ask the court to dissolve the company in the event of a deadlock in corporate decision or other emergent situation.[112]

Thus, in terms of corporate control no difference exists between a 49 percent shareholder and a 34 percent shareholder. Of course, in connection with the reservation of nonmandatory items to a supermajority in the articles of incorporation, a 49 percent shareholding could strengthen the foreign investor's bargaining leverage.

111. *Id.* at arts. 366, 385(2), 402, 403, 466, 467, 542.
112. *Id.* at art. 520.

D. Directors

The management of the company is vested in the board of directors, except for issues specifically reserved to the shareholders by the Commercial Code or in the articles of incorporation.[113] There are no special restrictions on the membership of the board of directors. Expatriates, including non-resident expatriates, may be directors. A *Chusik Hoesa* must have at least three directors.[114] The term of the directorship may not exceed three years, but reelection is permitted.[115]

In the case of a joint venture company, the number of directors nominated by foreign shareholders may not exceed the foreign equity proportion. For example, if a company has six directors, a 50 percent foreign shareholder may not nominate more than three directors. Also, a director nominated by a foreign shareholder may not be granted a tie-breaking vote.[116]

The legal status of a representative director is important in Korea, although the concept has no equivalent in some other jurisdictions. Under Korean law, only the actions of the representative directors will bind the company.[117] Thus, execution of contracts or other acts by a representative director will bind the company, while the other directors exercise no similar powers. Accordingly, if a director, other than a representative director, wants to act on behalf of the company, a power of attorney or other evidence is necessary to show that the requisite power has been delegated by the representative director.

There may be multiple representative directors, and their powers may be several or joint.[118] In the former case each representative director can bind the company, while joint representative directors must act together to establish legal duties for the company. A practical difference between several and joint representative directors is that the latter must mutually agree and cooperate on all legal acts. International legal practitioners advising on joint venture structures in Korea usually recommend the system of joint representative directors. Normally, each side is entitled to nominate one representative

---

113. *Id.* at arts. 361, 393.
114. *Id.* at art. 383(1).
115. KCC, *supra* note 1, at art. 383(2).
116. *See* EPB Notice 89-5, arts. 4.4, 4.5 (Sept. 29, 1989) [hereinafter EPB Notice 89-5].
117. Sometimes apparent authority is found if a person other than a representative director is allowed to use a title such as president, vice president or chief executive officer. KCC, *supra* note 1, at art. 395.
118. *Id.* at art. 389.

director, and the Korean representative director is likely to have more established relations with the clients, vendors, bankers, and other contractors of the joint venture in Korea. Therefore the foreign representative director often wishes some assurance of participation in company decisions.

E. Auditors

The legal requirement of a statutory auditor may also be unfamiliar to American investors, though the institution exists in Latin American and other civil law jurisdictions.[119] Under the Commercial Code, all *Chusik Hoesa* must have one or more internal auditors, in addition to an independent accounting and auditing firm.[120] No particular professional requirement applies for this position. The primary responsibility of an auditor consists of inspecting the accounting and general operations of the company, and reporting such findings to the shareholders.[121] For this purpose, the auditor may at any time examine the books, records, and other documents of the company and participate in the meetings of the board of directors in order to inspect the agenda and to express his opinions.[122]

Furthermore, to protect the company and the shareholders from the misconduct of directors or other malfeasance of officers, the auditor is entrusted with other important powers including:

(1) The auditor may instruct a director to desist from an act, if the action contemplated is contrary to law or to the articles of incorporation and is likely to result in irreparable damage to the company;[123]

(2) In the event that the company must institute legal action against a director, the auditor decides whether to bring suit against the director. If a lawsuit is initiated, the auditor represents the company for the restricted purpose of that legal action;[124]

(3) The auditor may request the court to rescind or nullify improper activities relating to shareholder resolutions, capital increases or reductions, consolidations or mergers, or incorporation of the com-

---

119. In Mexico, for example, a *sociedad anonima* must have a *comisario*, or statutory auditor. *See* A. HOAGLAND, COMPANY FORMATION IN MEXICO C-15 (1980).

120. KCC, *supra* note 1, at arts. 312, 409; Law on External Auditing, *supra* note 109, at art. 2. Compulsory auditing by an independent accountant applies only if total assets of a *Chusik Hoesa* are not less than *won* 3 billion.

121. KCC, *supra* note 1, at arts. 412-13.

122. *Id.*

123. *Id.* at art. 402.

124. *Id.* at art. 394.

pany;[125] and

(4) The auditor must examine the operation and accounting of the company and prepare an annual audit report, which is submitted to the annual meeting of the shareholders, via the representative director.[126]

Although the Korean Commercial Code grants broad authority to the auditor, in practice the auditor's role is often minimized in Korean companies. This occurs because ownership and management are unified in many Korean firms, and to the extent that the shareholders directly run the company, broad authority in the auditor is regarded as cumbersome. Nevertheless, in a joint venture between Korean and foreign firms, the situation could be quite different. The auditor may be entrusted to inspect the business of the company in order to identify deviations from the joint venture agreement or articles of incorporation by employees.

F. Compensation for Directors and Auditors

Compensation for directors and auditors is decided by the shareholders. Arrangements for retirement benefits for the directors or auditors must be expressly stipulated in the articles of incorporation or in a bylaw specifically authorized by the articles of incorporation. Otherwise, tax disadvantages may result.

G. Fair Trade Regulations Affecting Joint Ventures

Beyond the already noted regulations concerning the ratio of directors and tie-breaking votes, the Economic Planning Board has imposed several other restrictions on the content of joint venture agreements.[127] Article 4 of the relevant EPB Notice provides that the following are considered to be unfair trade practices in joint venture agreements:

1. cases where raw materials, parts, equipment, related products, etc. are unreasonably required to be sourced from the foreign investor or any person designated by him;
2. cases where export of products manufactured by the joint venture company is prohibited or restricted by requiring the joint venture company to obtain the foreign investor's prior approval, except in regards to territories where the foreign investor is already engaged

---

125. *Id.* at arts. 376(1), 429, 529(1), 328.
126. KCC, *supra* note 1, at art. 447-4.
127. EPB Notice 89-5, *supra* note 93.

in ordinary sales activity or has granted an exclusive right of sale to a third party; and

3. cases where any product manufactured by the joint venture company is required to be exported exclusively through the foreign investor or any person designated by him, unless the foreign investor or the designated person assumes an obligation to accept such product at internationally reasonable prices and conditions and at reasonable times.

VIII. Foreign Exchange Control Regulations

The full amount of the foreign party's cash equity subscription in a Korean subsidiary or joint venture must be introduced within two years after the MOF approval for the investment.[128] Any conversion of foreign cash investment into Won currency must be reported to the MOF within one month after the conversion.[129]

For branches, introduction of the operating funds must be reported to the BOK within ten days after the close of every calendar quarter.[130] This fund inducement must be transmitted via a particular bank as selected by the branch, and introduction of funds in excess of U.S.$1,000,000 per year is subject to prior BOK approval.[131] The BOK advises the relevant tax office of the fund inducement.[132]

Under the FECA, all international agreements and payments must be approved in advance by the relevant authority, unless approval is expressly exempted by the Presidential Decree or Foreign Exchange Control Regulations.[133] Basically, export and import contracts and the concerned payments are easily approved by local banks to the extent that the agreements are based on "normal" payment conditions.[134] A service agreement involving U.S.$100,000 or less does not require prior approval.[135] For all other international agreements, prior discussion with the exchange control authorities or Korean legal counsel is advisable due to the complexity of the regulations. The

128. FCIA, *supra* note 3, at art. 11.
129. *Id.* at art. 38(1).
130. FECR, *supra* note 17, at art. 16-4(2).
131. *Id.*
132. MOF Ruling of Dec. 30, 1988, Waejaeong 2224-549.
133. FECA, *supra* note 2, at arts. 21-30; FECA E.D., *supra* note 50, at arts. 32-37.2.
134. FECA E.D., *supra* note 50, at art. 40(4). Of course, other trade restrictions (non-tariff barriers) are imposed under the Foreign Trade Act, the Food Hygiene Act and a number of other laws. Like the United States, Korea also has adopted the Harmonized System for trade control purposes.
135. FECR, *supra* note 17, at art. 9-7(11).

increasing bilateral trade surplus of Korea with the United States resulted in leniency in most areas over the past few years, however this could change. Korean banks are required to report to the tax office any foreign currency transaction involving U.S.$3,000 or more.[136]

Despite these complexities, repatriation of the principal amount of foreign investment and remittance of dividends, profits and royalties associated therewith are normally guaranteed under the FCIA and the FECR.[137] Former restrictions on repatriation have been discontinued, and free remittance is allowed not only for subsidiaries but also for branches.[138] Expatriate employees are also allowed to convert and remit salaries earned in Korea.[139] Free remittance of salary income is allowed as long as the amount remitted does not exceed two thirds of the total salary earned in Korea. Remittance of more than two thirds is possible if it can be proved that the local living expenses, including Korean taxes are less than one third of the total salary.[140]

VIX. FINANCING

A branch or a subsidiary established in Korea by a foreign enterprise can, in principle, borrow money from Korean domestic banks or Korean branches of foreign banks without legal restrictions. Foreign currency loans from local sources are also available but only for the limited purpose of financing the importation of capital goods or the repayment of foreign loans.[141] Financing from overseas lenders is possible, subject to MOF approval; however, for several years the MOF has seldom approved foreign loans because of Korea's current account surplus and the consequent inflationary pressure.[142] To obtain a local bank loan either in Won or in foreign currency, a Korean branch is usually expected to provide the lender with a letter of guarantee issued by its home office. A nonresident foreign entity may also procure a foreign currency loan from a Korean bank or a Korean branch of a foreign bank. Procurement of a Won currency

136. MOF Ruling of Dec. 30, 1988, WAEJEONG 2224-549.
137. FCIA, *supra* note 3, at art. 4; FECR, *supra* note 17, at arts. 14-1 to -4.
138. FECR, *supra* note 17, at arts. 14-3, 16-7.
139. *Id.* at art. 11-33(12).
140. *Id.*
141. *Id.* at art. 2-32; Regulations on Foreign Currency Loan and Deposit Affairs, *promulgated by* the Banking and Monetary Administration Committee, as last amended on June 1, 1989.
142. Moskowitz, *How to Deal With Financial Culture Shock in Korea*, Asian Wall St. J., Feb. 8, 1990, at 6, col. 4.

loan by a nonresident foreign entity is impossible under the Foreign Exchange Control Act.[143]

Generally speaking, some or all of the following financing options may be available to the Korean establishment of a foreign firm:

1. Debt financing
   a. Local bank loan, including commercial paper/overdraft facility
      (i) Won currency loan
      (ii) Foreign currency loan
   b. Local loan from other sources
   c. Local bonds or debentures
   d. Foreign loan (from overseas lender)
   e. Foreign bonds
   f. Discount of Usance Instruments or Installment Paper
   g. Other Commercial Paper
   h. Open and Current Accounts
2. Equity Financing
   a. Public offering of new shares
      (i) Common shares
      (ii) Non-voting shares
   b. New Shares issued to a third shareholder
   c. Equity increases by existing shareholders

The more important of these options will be briefly described.

A. Local Bank Loan

The most straightforward solution to solving the financing needs of a Korean subsidiary would be to obtain a loan from a local bank. Currently, 54 foreign banks have established Korean branches, including 18 American, 15 European and 10 Japanese banks. Loans are available from these foreign banks as well as from Korean banks. The interest rate is indirectly controlled by the government. Currently, the official rate ranges from 10 percent to 13 percent. The effective interest rate, however, is between 15-19 percent, as a result of the compensating balance required by the banks. Even with this high interest rate, capital is scarce and local banks in Korea often lack adequate funds to service even preferred customers. Accordingly, before an investment decision is made, it would be wise for a potential

143. FECA, *supra* note 2, at art. 23.

investor to explore financing opportunities with relevant banks. Won currency finance includes ordinary loans, overdrafts, discounting of notes, export financing loans, and other facilities. Export financing loans are normally granted only to a small or medium enterprise (SME).

B. Collateral and Surety

In Korea it is very difficult to obtain unsecured bank loans. Local banks often require a personal guarantee or surety by a third party, in addition to a hypothec on realty or other asset-based security.

A *Cheodang-Kwon* or hypothec on real property is the most commonly used form of real security.[144] Establishment of a hypothec is effective upon registration with the court. The registration tax is 0.2 percent of the amount of debt secured, but an involuntary purchase of public bonds and other expenditures must also be incurred. If the borrower is unable to repay the loan, the creditor may auction the collateral and collect from proceeds the principal, interest, damages, and auction expenses.[145] Real property subject to an existing hypothec may be hypothecated again for the interest of other creditors, on the same principle as a second-mortgage. Priority among the creditors depends upon the time of court registration of the creditors' security interests. In principle, a hypothec only covers real property; however if a hypothec is established to encumber a plant building, then machinery, equipment, and other fixtures attached to the plant may become collateral under the hypothec.

If the borrower owns no real property, the borrower may offer its machinery, inventories, and other personal properties as collateral. Functionally equivalent to an equipment mortgage, the security takes the form of a *Yangdo Tambo* under Korean law. *Yangdo Tambo* involves transfer in trust of the title of the collateral from the debtor (or a third party real surety) to the creditor, on the condition that the title will be returned to the debtor (or a third party real surety) upon payment of the loan. This form of security may also cover real property. In fact, a *Yangdo Tambo* interest in personal property is

---

144. The concept of "*hypothec*," as regulated under Articles 356-72 of the Korean Civil Code, is similar to the common law concept of the mortgage, but is slightly different in that the *hypothec* does not involve a contingent transfer of ownership to the creditor. Yet the Korean term "*cheodang-kwon*" is often translated as mortgage.

145. KCC, *supra* note 1, at art. 360, Law No. 471 (Feb. 22, 1958), *as amended by* Law No. 4199 (Jan. 13, 1990).

often precarious, because a third party will acquire good title to the collateral if it has been purchased from the debtor in good faith.[146]

In sum, a Korean local presence which does not hold title to any real property will have a hard time procuring a loan from local banks. Loans from a foreign bank's Korean branch will depend upon the global relationship between the foreign investor and the foreign bank. Moreover, due to restrictions on swaps and other Won facilities, foreign banks may not be able to advance all the loans they would like to extend.

One peculiarity of Korean banking practice is the requirement of personal guarantees for corporate obligations. Korean banks almost always require that a loan be guaranteed by a local affiliate and by the representative director and/or the financial director in their personal capacities. The guarantors usually are required to sign the loan contract in the form of a joint and several suretyship. Under this arrangement, the guarantor and the debtor will be jointly and severally liable to the creditor. Bank demands for such security will normally not be extended to foreign shareholders or directors, because non-residents do not usually have sizeable assets in Korea. Instead, the local banks sometimes require a guarantee by a foreign bank.

C. Local Loans from Non-Bank Sources

Under Korean law, several other categories of financial institutions exist in addition to banks. These non-bank institutions are not subject to regulations based on the Bank Act which covers only banks. The main non-bank institutions are: (1) insurance companies, (2) short-term finance companies, (3) merchant banks, (4) investment trust companies, (5) leasing companies and (6) venture capital financing institutions.

1. Insurance Companies

Loans by insurance companies are governed by the Insurance Company Assets Management Regulations, published by the Ministry of Finance.[147] A loan from an insurance company may be a practicable option for a foreign-invested establishment, if bank loans are

146. The creditor may resort to criminal remedies against the debtor. *See generally* Kim & McGowan, *Chattel Security in Korea*, 7 KOREAN J. COMP. L. 60 (1979).
147. MOF Notice of Dec. 3, 1988, BOHEOM 22330-490.

unavailable. However, the interest rate on these loans is generally at a higher rate than some of the other options.

2. Short-Term Finance Companies

Loans by short term finance companies are governed by the Regulation on Operation of Short-Term Financial Companies, which is promulgated by the Ministry of Finance.[148] Under this regulation, loans may be obtained from a short-term finance company unless the outstanding debt of the borrower exceeds 10 percent of the total outstanding loans of the lender.[149]

3. Merchant Banks

Merchant banks are subject to the same substantive regulations which apply to short-term finance companies.[150]

4. Investment Trust Companies and Lease Companies

These institutions generally are not permitted to extend loans to enterprises.[151] They may, however, offer finance lease arrangements for the purpose of acquiring machinery from local or foreign sources. Depending on the line of business of the foreign investor, it may also be possible to arrange leases for customers so that collection of receivables could be expedited. This could serve to increase sales and to alleviate cash flow problems.

5. Venture Capital Financing Institutions

Several institutions exist which provide financing for innovative ventures that may confront difficulties in acquiring capital due to the risk-averseness of other lenders.[152]

---

148. MOF Notice of Apr. 22, 1987, JUNGGEUM 2223.0-405.
149. MOF Notice, *supra* note 148, at art. 18-2.
150. MERCHANT BANK ACT, art. 9, Law No. 2825 (Dec. 31, 1975), *as amended by* Law No. 3177 (Dec. 28, 1979).
151. EQUIPMENT LEASE BUSINESS PROMOTION ACT, art. 7, Law No. 2664 (Dec. 31, 1973), *as amended by* Law No. 3912 (Dec. 31, 1986); SECURITY INVESTMENT TRUST BUSINESS ACT, art. 21, Law No. 2129 (Aug. 4, 1969) *as amended by* Law No. 2956 (Dec. 31, 1976).
152. Several government-invested organizations and a dozen private venture capital companies lend funds. Private venture capital companies are regulated by the SME COMMENCEMENT ASSISTANCE ACT, Law No. 3831 (May 12, 1986) *as amended by* Law No. 3904 (Dec. 31, 1986).

D. Local and Foreign Bonds

The issuance of bonds and debentures is subject to quantitative limits specified in the Korean Commercial Code. This limit is either twice the total of equity capital (issued and outstanding capital) and reserves, or twice the total of net assets, whichever is lower.[153] The term "reserves" includes any issue premium of outstanding shares or other paid-in capital surplus and earnings retained under a mandatory requirement.[154] The term "net assets" means total assets minus total liabilities, which equals paid-in capital plus retained earnings (or minus accumulated losses).

The issuance of foreign bonds, that is, bonds floated in overseas financial markets, is subject to approval of the Ministry of Finance under the Foreign Exchange Control Act.[155] Under this Act, in addition to the Commercial Code limitation as discussed above, foreign bonds may be issued only for the limited purposes of: 1) financing import of foreign capital goods; 2) investment in a foreign country; 3) financing imports of subparts of capital goods to be reexported in three or more years; or 4) inducement of state-of-the-art technology.[156] Moreover, foreign bonds may be issued only when the issuer 1) has issued outstanding capital of W10 billion or more, 2) has continuously recorded a profit for the most recent three years, and 3) when the issuance will not degrade the international credit standing of Korea. Needless to say, these criteria confer a considerable degree of discretion on the MOF authorities.

E. Usance or Installment Settlement of Imports

Import of products on a usance or installment basis could also be contemplated to ameliorate the financing problems of a foreign-invested enterprise.[157] Import on an installment basis for up to 3 years is allowed for the following commodities:

1. Capital goods for export business;
2. raw materials for products to be exported on an installment

153. KCC, *supra* note 1, at art. 470.

154. *Id.* at arts. 458-459.

155. FECA, *supra* note 2, at arts. 24-26; FECA E.D., *supra* note 50, at art. 35; FECR, *supra* note 17, at arts. 14-5 to -17.

156. FECR, *supra* note 17, at art. 14-7.

157. A usance or installment basis import will involve delayed payment of the purchase price. For discussion of usance drafts, *see, e.g.*, H. HARFIELD, BANK CREDITS AND ACCEPTANCES 116-53 (5th ed. 1974).

basis;
3. raw materials for a foreign currency generating business;
4. machinery for heavy industry; and
5. defense industry products.

Usance basis (up to 90 days) imports are allowed for products on which the customs duty is 10 percent or less.

F. Open and Current Account

The establishment of an international open and current account, subject to periodic clearance of balances every six months, is allowed only if the foreign shareholder owns at least 50 percent of the Korean subsidiary.[158]

G. Equity Financing

1. Public Offering of New Shares

The issuance and public offering of new shares is governed by the Korean Commercial Code and the Securities Exchange Act. The Securities Exchange Commission (SEC) has published several important regulations under the Security Exchange Act. For the purpose of a public offering of new shares, SEC regulations require that:[159]

1. Five years or more have passed since incorporation of the issuer;
2. The paid-in capital is W2,000,000,000 or more, and accounting net assets are W3,000,000,000 or more;
3. The net asset value of shares is 50 percent or more of par value, and the going concern value (based or discounted profit projections) exceeds par value;
4. The return on paid-in capital for the most recent two (2) years is not less than fifteen percent (15%);
5. Debt/equity ratio does not exceed 150 percent of the industry average;
6. Conversions of capital surplus or retained earnings to stated capital (similar to stock dividend) during the prior two (2) years do not exceed certain percentages computed according to a complex formula; and increases in paid-in capital for the most recent two years are less than 50 percent of the stated capital of two years

---

158. *Id.* at art. 17-1.
159. Law No. 2920 (Dec. 22, 1976), *as amended by* Law No. 3945 (Nov. 28, 1987). Revisions to the SEC regulation were announced March 28, 1990. This amended regulation still awaits formal MOF approval which is expected in April, 1990.

before.
7. Share transfers among related shareholders have not occurred during the year preceding the offering;
8. Clearing house privileges have not been suspended for the most recent year;
9. No serious legal dispute exists;
10. The independent auditors have expressed unqualified (clean) opinions on the financial statements of the issuer; and
11. For subsequent listing of the shares on the stock exchange, 30 percent or more of the total issued and outstanding shares must be offered to the public.

Not only common shares but also nonvoting preferred shares can be offered publicly, and nonvoting shares are currently being absorbed by the investing public.[160]

2. *New Shares Issued To a Third Shareholder*

Issuance of new shares to a third shareholder could be a workable idea in certain circumstances. However, such an arrangement would, of course, result in a transformation of a two-party joint venture to a multiple shareholder structure.

3. *Equity Investment by Existing Shareholders*

With the requisite Ministry of Finance approval,[161] the equity capital of a foreign-invested enterprise may be increased. Provisions for preemptive rights in most joint venture documentation would, of course, assure maintenance of the original equity ratio. Given the limited availability of working capital for foreign-invested enterprises in Korea, a number of disputes have arisen as a result of disagreements between joint venture partners regarding the need for subscriptions of additional equity, or over the size and timing of such capital increases.

4. *Securities Regulation: Going Public*

Under the Capital Market Promotion Act, the Securities Exchange Commission is authorized to recommend public offerings of 30

160. Per unofficial statistics of Ssang Yong Securities Co. Ltd., non-voting preferred shares accounted for 6.1% of the Korean stock market as of January 4, 1990.
161. The legal nature of this approval is the same MOF approval for foreign investment as discussed in Section II. In practice, MOF approval for capital increase beyond the original approval is ordinarily granted without difficulty.

percent of the total issued and outstanding shares, as a minimum by financially sound companies as defined in the SEC regulations.[162] Under these rules, the SEC may request a company, including a foreign-invested company, to go public if the following criteria are satisfied:

1. the paid-in capital (*i.e.*, the par value of the issued and outstanding shares and the paid-in premium over par) exceeds W5,000,000,000 or the net assets exceed W10,000,000,000;
2. the debt/equity ratio is lower than the average ratio of listed companies;
3. the return on equity of the company exceeds the average interest rate on one year time deposits in Korean commercial banks; and
4. the company has been in existence for three (3) years or more.

In principle, such recommendation will apply evenhandedly to foreign-invested companies as well as to purely domestic entities, subject to the protection of vested rights of foreign investors whose projects were approved before December 31, 1988.[163] If a recommended company fails to follow the SEC recommendation, the SEC is empowered to take specific measures of redress. Such measures include limiting access to financing options, for example, bank loans and debentures.[164]

If a company yields to the SEC request, then 30 percent or more of the total issued and outstanding shares will have to be offered publicly. If the public offering is rendered by issuing new shares, the publicly offered shares must be 30 percent or more of the total shares after the capital increase. In practice, an offering consisting of 30 percent of the company's shares will satisfy the SEC requirement. The company may, of course, issue more than 30 percent if it so desires.

One way to avoid this SEC requirement is to establish a foreign subsidiary or joint venture not as a *Chusik Hoesa*, but as a *Yuhan Hoesa*, an alternative form of limited liability company available under Korean law.[165] Because of characteristics peculiar to a closed company, a *Yuhan Hoesa* is not subject to the going-public requirements enforced by the SEC[166]. One offsetting disadvantage of a

162. CAPITAL MARKET PROMOTION ACT, Law No. 3946 (Nov. 28, 1987)[hereinafter CMPA].
163. This final decision was a compromise between the MOF and the foreign invested companies, particularly the American Chamber of Commerce in Korea.
164. CMPA, *supra* note 162, at art. 5.
165. *See generally* Yoo, *To Form a Stock Corporation in Korea*, 1 KOREAN J. COMP. L. 101 (1973).
166. CMPA, *supra* note 162, at art. 2(3).

Yuhan Hoesa is that it may not issue bonds or debentures.[167]

X. Approval for Modifying Scope of Operations

The legal feasibility of entering into additional lines of business beyond the scope of the original investment approval is also of great significance to foreign investors. Generally, changes in the scope of business must be authorized by specific government approval of the Ministry of Finance. This requirement does not impose an insurmountable obstacle, provided that the foreign investor seeks to expand into sectors that are not restricted for new investments. As in the original procedure, the FECA and FCIA govern any additional business by a branch or a subsidiary, respectively. Under the Foreign Exchange Control Regulations, branch activities are confined to the business approved and other incidental business directly related hereto.[168] Any further business may be conducted only after receiving BOK approval. Additional business by a subsidiary is governed by the Guidelines to the Operations of Foreign Invested Companies.[169] This Guideline permits a foreign-invested company to operate any new business so long as the gross revenue therefrom does not exceed 5 percent (1 percent in the case of a lease of real property) of total revenues of the enterprise.[170]

Additional business activities producing revenue in excess of the above-mentioned amounts may be conducted upon MOF approval. Different criteria apply depending upon the level of foreign ownership.

Upon application, companies with less than 50 percent foreign ownership will be allowed to expand their operations to the extent that the new activities belong to the "open" sector under the Investment Guidelines.[171] Even if the additional activities do not belong to the open sector, they may be authorized if they directly relate to the originally approved activities *or* if the foreign-invested company satisfies the standards required of new investors in that subsector.

Approval for additional activities of companies with 50 percent or more foreign ownership will differ depending upon whether the additional activity involves manufacturing. All manufacturing activ-

---

167. *See supra* note 17 and accompanying text.
168. FECR, *supra* note 17, at art. 16-5(1).
169. MOF Notice No. 88-16, (Aug. 6, 1988); FCIA, *supra* note 3, at art. 13(2).
170. *Id.* at arts. 4(1), 13(2).
171. *Id.* at art. 4(2).

ities will be allowed to the extent that manufacturing is open to foreign investors.[172] Nonmanufacturing activities will be allowed only to the extent that the additional operations directly relate to the originally approved activities *and* the field is open to new investors.[173]

XI. The Alien Land Ownership Act

Under the Alien Land Ownership Act, all individuals or entities of foreign nationality must obtain an approval by the Ministry of Home Affairs (MHA) before acquiring legal title or other real rights (*Sachenrecht*) in the land within Korea.[174] For purposes of this MHA approval, Korean branches of foreign entities as well as corporations owned 50 percent or more by foreign interests are regarded as aliens.[175] As far as land ownership is concerned, MHA approvals have been available primarily to manufacturing joint ventures in Korea. Approvals, which may be difficult for wholly-owned subsidiaries to obtain, have usually covered purchase of manufacturing sites and improvements. Company housing for expatriate or Korean employees has also been opened to foreign ownership in some cases.

A branch or subsidiary engaged in a service business usually cannot obtain MHA approval to own land. One exception to this is the Korean branch of Citibank, which acquired a sizable piece of land for erection of its office building.[176] The purchase of a building without the underlying land is legally possible, but such an arrangement is impractical. Lease agreements, used by most foreign businesses, need not be approved by the MHA. If the lessee wants to register the lease to secure the repayment of key money deposits, however, MHA approval is necessary. Because such deposits may be very large, approval often is advisable.

XII. Conclusion

The legal environment of foreign business operations in the Republic of Korea is complex and incessantly changing. Consequently the present introductory discussion can offer no more than a "snap-

172. *Id.*
173. *Id.*
174. Alien Land Ownership Act, Law No. 718 (Sept. 18, 1961), *as amended* July 3, 1968.
175. *Id.* at art. 6.
176. Citibank played a major role when Korea still suffered trade deficit and shortage of foreign currency. This contribution to the Korean economy may have resulted in special consideration of its application.

shot" of some prominent features of a regulatory system in flux. To obtain a more fully holographic view of the Korean legal environment, there is no substitute for timely consultation with qualified local counsel.

Full evaluation of the practical impacts of the Korean legal system on foreign business operations would require attention to many important issues that are beyond the scope of this article, such as various planning options[177] and details of the intellectual property regime.[178]

The dominant trend of legal developments in Korea over the past ten years has been toward gradual liberalization of restrictions on foreign entry. Sectoral openings have been linked to shifts in the pattern and volume of trade between Korea and the United States. Loosening of legal controls on capital movements will remain a topic of negotiation in the Uruguay Round, in the OECD and bilaterally. The liberalization trend is likely to continue, although alterations in the scope of marketing permitted to foreign enterprises may be accompanied by a commitment to "national treatment" that cuts both ways.

Only a comprehensive assessment of the full range of the Korean legal order's impacts will enable decision-makers to develop realistic strategies for doing business in Seoul. With the Korean domestic market steadily growing in wealth and sophistication, Korea is becoming a more attractive destination for foreign entrepreneurs who are looking ahead to the Twenty-First Century as a Pacific Century. Law, like business, is growing less insular in theory and practice; and as this trend continues, more American lawyers will have occasion to interact with the Korean legal system, and more Korean lawyers to interact with American clients and counsel.

177. BASKERVILLE & KIM, *supra* note 23, at A-12 to -24.

178. *See, e.g.*, Hyun, *Legal Aspects of Technology Licensing in the Republic of Korea*, 27 COLUM. J. TRANSNAT'L L. 53 (1988).