



Newsletter

July 2006

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

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

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International Tax News

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1. The New International Tax Coordination Law Became Effective as of May 24, 2006

The new International Tax Coordination Law (“ITCL”), which was introduced in our previous Newsletter of April 2006, was ratified at the extraordinary session of the National Assembly in May, and has been in force since May 24, 2006. The new ITCL includes the codification of substance-over-form rule, improvements to transfer pricing rules and amendments to anti-tax haven rules. More information on the new ITCL are available in our April 2006 Newsletter.

2. Tax Haven Countries to Apply New Withholding Taxation Rules

The Korean Government has designated Labuan, Malaysia as a tax haven territory. Under the new withholding rules of Article 98-5 of the Corporation Tax Law (“CTL”) (and Article 156-4 of the Individual Income Tax Law), if foreign (non-Korean) companies or non-residents reside in a tax haven territory or country designated by the Korean Government, they are subject to withholding tax on Korean source income including interest, dividends, royalties, and capital gains from transfer of shares as stipulated under the domestic tax laws regardless of whether they are residents of countries concerned that have tax treaties with Korea. As a result, interest, dividend and royalties paid to foreign companies or non-residents residing in the designated territory (Labuan, Malaysia) will be subject to Korean withholding taxes at the rate of 27.5 percent (including resident surtax) at source of payment. On the other hand, for capital gains from transfer of shares, withholding tax will be the lesser of the 11 percent (including resident surtax) of the sales proceeds and 27.5 percent (including resident surtax) of the capital gains.

However, when a recipient (who is actual beneficiary) of the income concerned obtains a prior approval from the Commissioner of the National Tax Service (“NTS”), then the tax rate under the tax treaty shall apply. Withholding tax rates under the tax treaty by and between Malaysia and Korea is 15 percent (including resident surtax) on interest, 10~15 percent (including resident surtax) on dividends and royalties, and zero percent (withholding tax-exempt) on capital gains from transfer of shares, respectively. If they fail to apply for or obtain 'prior approval', foreign (non-Korean) companies or non-residents of Korea can file an amended withholding tax return for tax refund claim with due presentation of written documents proving they are the legitimate beneficial owners under the tax treaty within 3 years from the last day of the month when the taxes are withheld.

Tax Law Changes

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1. Extension of Pre-Appeal Period to 30 days

The National Tax Basic Law has been amended to extend a valid period for filing a pre-appeal with the Korean tax authorities by additional ten (10) days. Thus, taxpayers may file a pre-appeal with the relevant district tax office or regional tax office within 30 days after receiving a pre-assessment notice to examine whether the taxes are properly assessed.

(Tip)

Taxpayers' Right Charter

Your rights as a taxpayer must be respected and guaranteed pursuant to the Constitution and other relevant laws.

For this purpose, tax officials must provide as much information and convenience as necessary for you to fulfill your obligation to pay tax in a faithful and sincere manner, and are obliged to carefully cooperate so that your rights may be protected and realized.

This bill is intended to notify you of your rights as a taxpayer in detail.

- i) You are deemed to be a sincere taxpayer and the tax documents you have submitted are deemed to be true unless you failed to comply with such obligation as bookkeeping and filing a tax return or you are suspected of tax evasion.
- ii) You reserve the right to be notified a tax examination in advance and the results of the examination unless tax laws prescribe otherwise and reserve the right to apply for the postponement of examination under certain conditions.
- iii) You reserve the right to receive assistance from a tax expert during examination and are not subject to double examination unless prescribed otherwise by law.
- iv) You reserve the right to protect your privacy with regard to information related to your own tax liability.
- v) You reserve the right to be provided with information, on a timely basis, necessary for the exercise of your rights.
- vi) You reserve the right to be protected in a legitimate and expeditious manner when your rights or interests are undermined by illegal or wrongful assessment or when not receiving proper treatment.
- vii) You reserve the right to be treated fairly by tax officials at all times.

Bilateral Tax Treaty Development

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1. Second Protocol to the Tax Treaty between China and Korea

The second protocol to the tax treaty between China and Korea has become effective as of July 10, 2006. According to Article 5 of the protocol, application of the 'deemed foreign tax credit' allowed to residents of each country, which was valid until December 31, 2004 in the Tax Treaty, is extended until December 31, 2014 (this Article came into force retroactively starting January 1, 2005). Therefore, a resident of each country is continuously entitled to claim the credit of deemed foreign taxes that would have been payable if there had not been the legal provisions concerning tax reduction, exemption or other tax incentives of the other country for the promotion of economic development.

2. Other Development of Tax Treaties

The tax treaties between Canada and Korea and between Thailand and Korea have been amended, but have not been ratified by the National Assembly yet. According to the revised tax treaty between Canada and Korea, regarding a company whose real property consists of more than fifty percent of its whole assets, gains from transfer of shares thereof may be taxed at the sourcing country where that company resides. Also, the maximum tax rates (exclusive of resident surtax) have been reduced to 5~15 percent from 15 percent for dividend, to 10 percent from 15 percent for interest, and to 10 percent from 15 percent for royalty, respectively.

The tax treaty between Thailand and Korea allows 'deemed foreign tax credit' to each country. Also, the Thailand / Korea tax treaty reduces the maximum tax rates (exclusive of resident surtax) to 10 percent from 15~20 percent for dividend, and 5~15 percent from 15 percent for royalty, respectively.

Korea has signed agreements with Albania and Iran to avoid double taxation and tax evasion of income in Seoul on May 17, 2006, and on July 5, 2006, respectively. The two agreements are waiting for the ratification of the National Assembly.

New Ruling

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1. Earned Income Classification by Type of Payment Arrangement in Liaison Office

According to the ruling of the NTS (*Seomyon Iteam-511, 2006.4.21*), if a foreign (non-Korean) company having a liaison office in Korea that does not carry on revenue-generating activities pays salaries to its local employees from its bank account to local each employee's bank account directly, the salaries shall be treated as Class B earned income of the employees in Korea. However, if salaries are paid by the foreign company to its local employees indirectly by wiring the salaries to the bank account of the liaison office, the salaries shall be treated as Class A earned income of the employees and thus shall be subject to income tax withholding in Korea.

2. Treatment of Signing Bonus

Where a individual taxpayer enters into an employment agreement with a company and is paid 'signing bonus' on the conditions that the signing bonus should be returned to the employer if the taxpayer fails to fulfill the employment agreement, the signing bonus shall be deemed as earned income in accordance with Article 20 of the Individual Income Tax Law ("IITL").

Also, if a signing bonus is fully paid in advance at the time of the agreement, the amount paid shall be allocated over the entire employment period prescribed in the agreement and should be included in the earned income of the taxpayer, which is subject to withholding tax according to the IITL (*Seomyon Iteam-402, 2006.3.29*).

3. Tax Treatment of Gains from Exercise of Stock Options Granted Overseas

In the case where a foreign (non-Korean) employee who is relocated to a Korean branch of a foreign (non-Korean) company (after he/she was granted a right overseas to buy certain amount of shares of the foreign company without additional payment when the grace period lapses) exercises his/her right and acquires shares of the foreign company while residing in Korea, the time to recognize salary income earned is the date when the shares were acquired through exercising the right granted (*Seomyon 2team-928, 2006.5.24*).

New Ruling, *Continued*

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4. **Penalty for Non-filing of Tax Exemption Application for Relief of Tax Treaty**

In order for a foreign (non-Korean) company to benefit tax exemption treatment on capital gains under the tax treaties, the foreign company must file an application for tax exemption along with a certificate of residency (which is issued by the competent authorities of the country where the foreign company resides) with the relevant district tax office no later than the 9th day of the following month of the month when such payment is made in accordance with the CTL.

However, there is no provision in the CTL regarding how to deal with in the case where a certificate of residency or an exemption application is not filed for relief of the tax treaty. In this connection, the NTS ruled in its ruling (*Seomyon 2team-977, 2006.5.30*) that where a tax exemption application is filed with the relevant district tax office without a certificate of residency, the a party bearing withholding tax obligation shall withhold taxes and penalties in accordance with the CTL alone, disregarding tax treaty relief.

But the tax amount withheld including penalties may be refunded when required documents (a certificate of residency, etc) are filed with the relevant district tax office.

Horwath Choongjung News

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1. Horwath Choongjung's 2006 Summer Workshop Held in June

Horwath Choongjung and Horwath Choongjung Consulting Corporation, an affiliate of Horwath Choongjung, have held the 2006 Summer Workshop for two days from June 16 to June 17 at the Vivaldi Park Resort in HongCheon, Kangwon-do, where about 90 partners and staffs have participated.

The workshop has proceeded in three sessions of continuing professional education ("CPE") program for CPAs, Tax & BPO staffs and Consultants. The summer workshop was a valuable opportunity for all our staff to share once again the vision of Horwath Choongjung of growing into the Unique Alternative Providing Excellence in Client Services.

2. Introduction of Newly Joined Managers and Directors

The following experienced professionals have recently joined Horwath Choongjung. We expect that Horwath Choongjung will be able to provide more upgraded services to our clients by utilizing their experiences and knowledge.

Tae-Jin Koo (Executive Consultant, KICPA)

- Pusan National University, BA.
- CEO of Keystone Valve (an affiliate of Tyco International)/ AhnKwon Accounting Corporation.

Young-Chul Kim (Director, Head of FAS Group, AICPA)

- The George Washington University, MA & MBA.
- Professional of Financial Advisory Service
- Samsung Securities Co. Ltd., HSBC Ltd.

Tae-Sik Kim (Senior Manager, KICPA)

- Seoul National University, BA & MBA.
- Samil Accounting Corporation (PriceWaterhouseCoopers)
- Korea Accounting Institute

Mu-Rim Choi (Senior Manager, KICPA)

- Seoul National University, BA & MBA.
- Samil Accounting Corporation (PWC), Shinhan Accounting Corporation.

Horwath Choongjung News, *Continued*

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SeungYong Choi (HTL Team Leader, Manager)

- Korea University, BA.
- Kyounggi University, Master in Tourism Management.
- Under Ph.D Course, Kyounggi University.
- Daewoo Corporation, Hilton Hotel, Daewoo Hotel in Hanoi, HTC Co.

Eunjoo Lee (Senior, AICPA)

- Yonsei University, BA.
- University of Strathclyde (UK), MS in Finance.
- SK Networks/ Samil Accounting Corporation (PWC)

3. Horwath Choongjung has won several strategic consulting projects

Horwath Choongjung Consulting Corporation (“HCCC”), an affiliated company, has recently won several strategic consulting projects through bidding process as follows:

- LG Phillips LCD: system development for ABC (Activity Based Costing) and BPS (Business Planning & Simulation)
- The Korea Chamber of Commerce and Industry (“KCCI”): management consulting for HR organization strategy
- LIG Insurance Co., Ltd.: ABC system development

HCCC has grown as one of leading companies in strategic management consulting, technology services and accounting/finance consulting with considerable experiences.

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