



Newsletter

January 2007

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 a 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.

Topics covered in this edition of Newsletter include

- ◆ **2007 Tax Law Changes**
 - ▶ Revision of Tax Audit Related Provisions
 - ▶ Non-resident Filing Tax Refund Claim on Taxes Withheld Allowed
 - ▶ Withholding Tax Rate on Interest Income of Non-resident Investors Lowered
 - ▶ Introduction of Low Rate Taxation on Dividend from Investment Trust, etc. Investing in High Risk Bonds for both Resident and Non-resident Investors
 - ▶ Introduction of Common Business Registration Number to be used for Head Office and its Branch
 - ▶ Introduction of Earned Income Tax Credit
 - ▶ Discriminatory Penalty Rates on Delinquent Reporting depending on Degree of Insincerity
 - ▶ Other Major Changes in Relevant Tax Laws
- ◆ **News on International Taxation in Korea**
 - ▶ New Designation of Tax Havens
- ◆ **Bilateral Tax Treaty Development**
 - ▶ Revision of Tax Treaty entered into with Canada
- ◆ **New Rulings**
 - ▶ Direct Foreign Tax Credit is allowed to Partner for Taxes paid on the Partnership's Income
 - ▶ Application of Transfer Pricing Rules on Giving More Favorable Payment Terms to Overseas Specially-Related Party
 - ▶ Scope of Software Consideration not Considered as Royalty
- ◆ **Horwath Choongjung News**
 - ▶ Horwath Choongjung Awarded as One of the Five Member Firms with a Remarkable Growth at HI Annual Conference

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

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2007 Tax Law Changes

Newsletter January 2007

We summarized below some of the major changes to keep you up-to-date on tax law changes in Korea. Most of the tax law changes we discuss below came into force effective from the fiscal year starting (or for payments/investments made or income earned) on or after January 1, 2007 unless indicated otherwise. [Please note that the tax rates provided below are exclusive of the resident surtax].

1. Revision of Tax Audit related Provisions

The revised National Tax Basic Law (“NTBL”) classifies tax audits clearly into two types such as regular tax audits and special (or targeted) tax audits performed based on tax evasion reporting, etc. In addition, the revised NTBL introduces the new provision that a tax audit shall be conducted for a minimum period of time required, and a qualified small-sized taxpayer (defined) may be exempt from a tax audit. An advance notice period for a tax audit is also extended from 7 days to 10 days.

2. Non-resident Filing Tax Refund Claim on Taxes Withheld Allowed

Under the revised NTBL, non-resident taxpayers and foreign corporations (defined), who have borne taxes through withholding by a payer, shall be allowed to file tax returns claiming refunds of taxes withheld within 3 years.

3. Withholding Tax Rate on Interest Income of Non-resident Investors Lowered

Under the Corporation Tax Law (“CTL”) and Individual Income Tax Law (“IITL”), interest income of certain non-residents (including foreign corporations) has been subject to 25% withholding tax. However, under the revised CTL and IITL, the withholding tax rate on interest income earned by non-residents from bonds issued by Korean governments or Korean corporations is lowered to 14%.

4. Introduction of Low Rate Taxation on Dividend from Investment Trust, etc. Investing in High Risk Bonds for both Resident and Non-resident Investors

Under the revised Special Tax Treatment Control Law (“STTCL”), a Korean resident who invests in an investment trust, etc., which invests certain percentage or more of its investment in the bonds issued by the low rated corporations, shall be taxed at 5% on dividend therefrom to the extent that the resident’s principal amount does not exceed Won 100 million. The same rule applies to a non-resident investor without a limitation on principal amount.

2007 Tax Law Changes, *Continued*

Newsletter January 2007

5. **Introduction of Common Business Registration Number to be used for Head Office and its Branch**

The Value-Added Tax (“VAT”) Law has required each independent business unit to be registered with a district tax office and the VAT statements to be issued by each registered business unit. However, under the revised VAT Law, if a qualified taxpayer (defined) obtains an approval from a district tax office upon application, its head office may register itself and its branches with its district tax office by one common tax registration number, and issue their VAT statements with such common tax registration number, effective from January 1, 2008.

6. **Introduction of Earned Income Tax Credit**

Under the revised STTCL, a qualified Korean (defined), who earns the income (defined) of less than Won 17 million annually including his/her spouse’s income and has two or more dependents (defined), may apply for an earned income tax credit. This provision shall be effective from January 1, 2008 and the ceiling of earned income tax credit is Won 800,000 per year.

7. **Discriminatory Penalty Rates on Delinquent Reporting depending on Degree of Insincerity**

Under the revised NTBL, discriminatory penalty rates will apply on delinquent reporting depending on a degree of insincerity. For an intentional (unfair) non-reporting and underreporting, the penalty rate shall be 40% whereas the penalty rates for mere non-reporting and underreporting shall be 20% and 10%, respectively. In the case where a reporting is made within one month after the due date, the penalty rate shall be reduced by half of the applicable rates.

8. **Other Major Changes in Relevant Tax Laws**

- **Scope of Majority Shareholder subject to Secondary Tax Liability Expanded**

Under the revised NTBL, the scope of the shareholder, who has the secondary tax liability for the taxes assessed on the invested company, is expanded from the shareholder holding more than 51% of the shares to the one holding more than 50% and controlling the company substantially. In this regard, the shares held by the specially-related parties (defined) shall be considered when calculating such shareholding ratio.

2007 Tax Law Changes, *Continued*

Newsletter January 2007

- **Revision of DRD Ratios for Financial Institution and Holding Company**

Under the revised CTL, the dividend received deduction (“DRD”) of an institutional investor has been lowered from 90% to 30% that is the identical ratio applied to regular corporations. In the case where a holding company (defined) holds more than 80% (40% for a listed subsidiary) of the shares of its subsidiary, the DRD ratio for dividends from such subsidiary will be increased from 90% to 100% from 2009, and the DRD ratio for dividends from other subsidiaries will be increased from 60% to 70% in 2007 and to 80% from 2008 sequentially.

- **Introduction of Business Purpose Bank Account for Individual Taxpayer**

Under the revised IITL, an individual taxpayer who has a double entry bookkeeping obligation shall open a bank account to be used only for business purposes and report the bank account details to its governing district tax office. In the cases of cash payment or receipt transactions related to provision of goods or services through a financial institution and salary and rental payment transactions, etc., a qualified taxpayer should use the reported bank account only. Otherwise, a penalty tax of 0.5% on the noncompliant amount will be assessed effective from January 1, 2008.

- **Capital Gains Tax Rate for Small and Medium Sized Companies Listed in Foreign Stock Markets Lowered**

Under the revised IITL, the capital gains tax rate for shares in small and medium sized companies (defined) listed in foreign stock markets has been lowered from 20% to 10%, which is the same as for shares in small and medium sized companies listed in Korean stock markets (i.e., KSE and KOSDAQ).

- **Discount Offered after Provision of Goods or Services Excluded from VAT Base**

A discount that is offered after provision of goods or services shall be excluded from a VAT base under the revised VAT Law.

- **Deduction of Input VAT for VAT Exempt Business Allowed when later used for VAT Taxable Business**

Non-deducted input VAT of goods purchased for a VAT exempt business shall be allowed deduction from output VAT when goods are later used for a VAT taxable business under the revised VAT Law.

2007 Tax Law Changes, *Continued*

Newsletter January 2007

- **Deregulation of Requirement for Credit Card Receipt to be Claimed for Input VAT Deduction**

According to the revised VAT Law, the requirement for the credit card receipt to be claimed for the input VAT deduction (i.e., writing down a business registration number of a purchaser or a service recipient on a credit card receipt) has been abolished.

News on International Taxation in Korea

Newsletter January 2007

1. New Designation of Tax Havens

The National Tax Service (“NTS”) has announced Liberia, Liechtenstein, Marshall Islands, Monaco, and Andorra as the designated tax havens on December 29, 2006. However, according to the International Tax Coordination Law (“ITCL”), tax havens include not only the designated countries or areas above but also the countries or areas where the actual tax obligation is less than 15% of the income. The new designation of the tax havens became in force upon announcement.

Bilateral Tax Treaty Development

Newsletter January 2007

1. Revision of Tax Treaty entered into with Canada

The revised tax treaty entered into by and between Canada and Korea on September 5, 2006 came into force on December 18, 2006. According to the revised tax treaty, the maximum tax rates (exclusive of resident surtax) are reduced to 5% from 15% for certain dividend income, to 10% from 15% for interest income, and to 10% from 15% for royalties, respectively. With respect to the shares in a company, more than 50% of the value of which is derived directly or indirectly from immovable property, capital gains from transfer of such shares may be taxed at sourcing country where the company resides.

New Rulings

Newsletter January 2007

1. **Direct Foreign Tax Credit is allowed to Partner for Taxes paid on Partnership Income**

In the case where a Korean corporation as a partner invested in a limited liability company (LLC) in the U.S. which elects pass-through taxation, and reported and paid taxes to the Internal Revenue Service (IRS) on the income from business in the U.S., the Korean corporation is allowed to claim a direct foreign tax credit for the taxes paid on partnership income by itself under Paragraph 1, Article 57 of the CTL of Korea (*Seomyon 2team-2215, 2006.11.01*).

2. **Application of Transfer Pricing Rules on Giving More Favorable Payment Terms to Overseas Specially-Related Party**

Where a Korean corporation has international transactions with its overseas specially-related party (“OSRP”) and offers more favorable payment terms to the OSRP compared to those offered to unrelated parties, the transfer pricing rules of Article 4 of the ITCL may be applied. To determine whether to apply transfer pricing rule thereto, actual facts and circumstances such as the reasons for allowing longer payment terms to its OSRP shall be considered (*Seomyon 2team-2164, 2006.10.26*).

3. **Scope of Software Consideration not Considered as Royalty**

In the case where a Korean corporation makes an agreement for distribution of software with a U.S. corporation which does not have a permanent establishment in Korea and distributes to Korean customers on the conditions that the source code is not provided to the Korean corporation and the software is a standardized product available for sale to unspecified general publics, and also the consideration is determined on a fixed basis, the consideration which the Korean corporation pays to the U.S. corporation shall not be considered as royalty income according to Article 14 of the tax treaty between the U.S. and Korea and Paragraph 9-2, Article 93 of the CTL of Korea (*Seomyon 2team-2052, 2006.10.13*).

Horwath Choongjung News

Newsletter January 2007

1. **Horwath Choongjung Awarded as one of the Five Member Firms with a Remarkable Growth at HI Annual Conference**

The annual meeting of Horwath International (HI) was held at Sheraton Hotel in Cape Town, South Africa from November 6 to November 10, 2006. HI offered various programs for presentations and discussions of the current status and visions on the topics of auditing, accounting, consulting and taxes, including sectional subcommittees on the subjects.

Above all, Horwath Choongjung was selected as one of the five member firms (the second place) that have accomplished remarkable growth among all the member firms around the world and awarded by Mr. Werner E. Rotach, the CEO of HI.

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