



Newsletter

July 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.

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Please contact any of the following individuals with any inquiries or comments.

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

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Horwath Choongjung News

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**Selected as Rating Service
Provider for “Korea Luxury
Brand Awards 2007” sponsored by
Korea Economic Daily**

Horwath Choongjung Consulting Corp. (HCCC) was selected as the rating service provider for the “Korea Luxury Brand Awards 2007” sponsored by The Hankyung Newspaper Company. HCCC will develop an analytic model in order to select the best brand in Korea and evaluate and select award recipients.

Despite continuing economic slump, consumers are showing extreme polarization trends in their propensity to consume and the consumers’ desire to purchase luxurious goods is increasing these days more than ever before. Therefore, it is necessary that the luxury brand should be popularized to satisfy the value for money of consumers in this world flooded with merchandises. Thus “Korea Luxury Brand Awards 2007” is intended to provide an opportunity to enhance the quality of the goods and consumers’ awareness by awarding the valuable brands, and contribute in strengthening international competitiveness of the Korean brands.

**Attended Horwath International
APRO 2007 Meeting**

Mr. H J Hwang (Managing Partner of Horwath Choongjung) and 3 more selected representatives attended Horwath International APRO 2007 meeting, which was held in Singapore from May 9th to May 12th.

Representatives from HI’s APRO member firms including Mr. Frank Arford (CEO of Horwath International) and Mr. Clement Chan (Director of HI Asia Pacific Region) attended this meeting and discussed about various subjects such as mutual cooperation for international audit service, RM, IFRS, etc. Especially, they provided specialty group program, which was divided into various groups (Tax, Audit, Risk Management, M&A), and offered an opportunity to the participants to share their experiences and knowledge.

Horwath Choongjung News, *Continued*

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Annual Promotion and Welcoming a New Executive Member

Horwath Choongjung newly admitted the following members to the partnership or director positions effective July 1, 2007.

QRM -T J Koo / Partner

Tax & BPO -J D Seo / Partner, G S Sim / Director

FAS -S C Song / Director (Acting Partner)

In addition, Mr. Y H Cho, who worked for Deloitte Anjin LLC in Korea as a Partner, joined the Tax & BPO unit as a QRM Partner starting July 1, 2007. His personal histories are as follows;

Seoul National University, MBA & BA (1975,1973)

Haskins & Sells Seoul Office (1974-1975)

Ahn Kwon & Co.(Deloitte), Tax Partner (1975-1988)

KMG office in Sydney (1981-1984)

Kellogg Korea, CFO (1988-1997)

Deloitte Anjin, Int'l Tax Partner (1997-2006)

Mr. Cho will be responsible for quality and risk management of the firm's Tax and BPO service practices.

Tax Law Changes

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We summarize below some of the major changes to keep you updated on tax law changes in Korea.

1. Introduction of New System on VAT Invoice Issuance by Purchaser

Under Article 126-4 of the revised Special Tax Treatment Control Law of Korea (“STTCL”), a purchaser who failed to receive a VAT invoice from the vendor (with an obligation of issuing a VAT invoice thereto) may issue the VAT invoice by itself through obtaining the confirmation from the pertinent tax office. A purchaser may issue such VAT invoice up to two cases per month and the transaction amount (including VAT) per case should be within the range of Won 100,000 to Won 5,000,000.

This new system shall be effective from the transaction incurred or to be incurred on or after July 1, 2007.

2. Non-taxation of Income distributed by Investment Trust, etc which is sourced from Capital Gains or Valuation Gains of Shares in Foreign Companies listed in Foreign Stock Exchanges, etc.

Under Article 91-2 of the revised STTCL of Korea, income distributed by an investment trust or an investment company (defined) to an individual investor and sourced from capital gains or valuation gains of its direct investments in the shares of the foreign companies listed in foreign stock exchanges (which are similar to the Korea Stock Exchange (KSE) or KOSDAQ), which is incurred and paid on or after June 1, 2007 until the end of 2009, shall not be taxed.

3. Additional Tax Deductible Limit of Entertainment Expenses incurred for Cultural Activities

An additional tax deductible limit of entertainment expenses incurred for cultural activities shall be allowed under Article 136 of the revised STTCL of Korea from the fiscal year to which September 1, 2007 belongs. To enjoy such additional entertainment deduction, the cultural activity related entertainment expense should exceed 5% of the total entertainment expense amount, and the additional tax deduction for the excess amount shall be allowed up to 10% of the general entertainment tax deductible limit. The cultural activity related entertainment expenses include the ticket prices of play or exhibition, and purchase price of publications or music CDs, etc.

Tax Law Changes, *Continued*

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4. **Revision on Mandatory National Health Insurance for Foreigners**

Since January 1, 2006, the medical insurance policy has required all foreigners to join the Korean medical insurance program. However, from July 25, 2007, foreigners can exempt themselves from participation of the mandatory national health insurance program with the appropriate supporting documents if they are already covered by insurance program provided by their home country, foreign insurance, or an employer that provides with the same level of medical coverage such as those provided under Article 39 of the National Health Insurance Law of Korea during their stay in Korea.

Bilateral Tax Treaty Development

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1. **Revision of Reduced Withholding Tax Rate on Dividend under Philippines / Korea Tax Treaty**

According to the revised tax treaty between the Philippines and Korea, the reduced tax rate on dividend income stipulated in Paragraph 2, Article 10 of the tax treaty was revised from 15% to 25% for all other cases except the case that the beneficial owner is a company (other than a partnership) which holds directly at least 25% where the 10% tax rate on dividend income is applied. The revised rate shall be applied to dividend income received on or after May 18, 2007.

2. **Revision of Thailand / Korea Tax Treaty**

The revised tax treaty between Thailand and Korea came into force on June 29, 2007. Under the revised treaty, the reduced tax rates on dividend income were revised to 10% from 15% or 20%. In the case of interest income, the 10% tax rate is still applicable in the case where the beneficial owner is a financial institution, and for all other cases, the reduced tax rate of 10% or 15% shall be newly applied depending on the cases. With respect to royalty income, the tax rates are differentiated from 15% to 5% for software, radio or television broadcasting, etc., to 10% for patent, trademark, etc., to 15% for industrial, commercial or scientific equipments or information.

In addition, the new articles were introduced in the revised treaty such as capital gains, dependent personal services, and artistes and sportspersons.

The revised reduced tax rates shall be applied for the payment on or after January 1, 2008.

3. **Effectuation of Tax Treaty between Lithuania and Korea**

The tax treaty between Lithuania and Korea came into force on July 14, 2007. According to the tax treaty, withholding taxes are generally limited to 10% for dividend income, interest income, and royalties.

Regarding dividend income, the 5% withholding tax rate shall be applied if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying dividend. For royalty income, 5% of the royalties shall be withheld provided that the royalties are paid for the use of, or the right to use, industrial, commercial, or scientific equipment.

The reduced tax rates shall be applied for the payment on or after January 1, 2008.

New Rulings

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1. **Treatment of Tax withheld on Deemed Dividend under Thin Capitalization Rule in case where Interest is waved later**

The National Tax Service of Korea (“NTS”) issued a new ruling (*Seomyon 2team-949, 2007.5.16*) that under the circumstances where a company borrowed funds from its foreign (non-Korean) shareholder and its borrowing related accrued interest expenses are denied the deduction and deemed as a dividend paid out to its foreign shareholder under the thin capitalization rule of the International Tax Coordination Law of Korea (“ITCL”), even if the company’s liability of accrued interest expenses are waived by the shareholder later, the taxes withheld on deemed dividend shall not be refunded. Under this ruling further, it is judged that a gain from liability exemption shall be treated as a taxable income in accordance with the Corporation Tax Law of Korea (“CTL”), even though the interest expenses are already denied deduction under the thin capitalization rule.

2. **Investment related Tax Credit is also applicable for Foreign Direct Investment for which Tax Exemption / Reduction Period has elapsed**

The NTS issued a new ruling (*Seomyon 2team-763, 2007.4.27*) that the investment related tax credit is also applicable for the foreign direct investments of which the tax exemption / reduction period has already elapsed, in the same way as for the Korean investments. The ruling also stipulates that the investment related tax credit shall not be applicable for the investments currently enjoying the foreign direct investment related tax exemption (100%) or reduction (50%).

3. **Scope of Permanent Establishment under the Consignment Processing Contract**

A new ruling was issued by the NTS that under the circumstances a Japanese company consigned its semi-finished goods to a Korean company for further processing, and the Korean company delivered the finished goods (that have been stored for storage, display or delivery) to the Japanese company, such place used for storage, display or delivery shall not be treated as a permanent establishment (“PE”) of the Japanese company under Paragraph 4, Article 5 of the tax treaty between Japan and Korea. However, if the Korean company has an authority to conclude a contract and exercises its authorities habitually for the Japanese company under Paragraph 5, Article 5 of the said tax treaty, the Korean company shall constitute a permanent establishment of the Japanese company (*Seomyon 2team-638, 2007.4.11*).

New Rulings, *Continued*

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4. Scope of Foreign Employee subject to Income Tax Reduction

According to a recent new ruling (*Seomyon 2team-497, 2007.3.23*), the NTS interprets that the scope of a foreign employee who can be entitled to individual income tax reduction stipulated under Article 18-2 of the STTCL of Korea includes a person residing permanently in foreign countries.

5. Determination of applicable Tax Treaty

A new ruling was released from the NTS for the case where a Korean company wires a license fee as royalty income to the bank account of a US company opened in Hong Kong. In such case, a reduced withholding tax rate under tax treaty between the U.S. and Korea shall apply. In addition, the ruling clarified that in the case where a royalty income is paid to a Hong Kong company, the CTL of Korea shall be the governing law as Korea does not have a tax treaty with Hong Kong. The ruling further interpreted that the tax treaty between China and Korea shall not apply for the royalty income paid to a Hong Kong company. (*Seomyon 2team-1169, 2007.6.15*).