Taxation in Korea

Taejin Park
- Korean Tax Update

Jaedok Lee
- Tax Efficient Holding Structure

Ashley Choi
- Key Ways to Approach Korean capital
Korean Tax Landscape

Taejin Park
Agenda

Section one  
Korean Tax Update.

Section two  
Audit trends

Section three  
Major issues facing foreign capital
Korean Tax Update

1. Tax Treaty Update

• The First Income Tax Treaty between Korea and Hong Kong
  ▪ Agreed to a comprehensive scope of tax information exchange including real estate-related tax
  ▪ Dividend withholding tax rate: 10%/15%

• Amended Korea-Luxembourg Income Tax Treaty effective in Sep 2013
  ▪ Deleted the provision that excludes holding companies established under the special law of Lux from the applicable scope of the treaty
  ▪ Added that nothing under the Treaty will be construed as restricting the application of any provisions of the laws of both countries which are designed to prevent the avoidance of taxes
Korean Tax Update

1. Tax Treaty Update, cont’d

- Protocol to amend Korea-Singapore Income Tax Treaty was effective in June 2013
  - It permits that if information is requested by a contracting state, the other state shall use its information gathering measures to obtain the requested information and shall not decline to supply information.

- Korea, U.S., U.K., Australia agree on offshore tax information sharing
  - Agreed with the US, UK and Australia to share offshore tax information fight cross-border tax evasion.
2. key Ruling Update

- In the recent court ruling, Cayman LP which was established as an intermediary entity is determined to be classified as a beneficial owner of the Korean sourced income and should pay corporate income tax in Korea.
- The case involves a LP established by a group of investors in Cayman Islands and the ruling provides that a comprehensive review must be conducted to determine that the LP constitutes a separate entity having its own rights and duties independent from its investors, in other words that the LP may be a foreign entity for Korean corporate income tax purpose.
Korean Tax Update

3. Amendment to the Tax Act for 2013

• The definition of “foreign corporation” would be extended as follows:

• Before

  ▪ A corporation with its headquarter or main office in a foreign country

• Amended

  ▪ A corporation with its headquarter or main office in a foreign country with the following requirements:

    i) having a legal personality in Korea,

    ii) Only comprised of partners with limited liability,

    iii) having the legal rights and liabilities that are distinct from its members, or

    iv) the same or the most similar kind of domestic entity constitutes a corporation under Korean laws
4. Proposed Amendment to the Tax Act for 2014

- New Compliance procedures for claiming tax exemption under the relevant tax treaties

- Before
  - Income exemption form withholding under the relevant tax treaties: Submission of an application for claiming tax exemption under the tax treaty.

- To be amended effective on Jan 2014
  - A beneficial owner receiving income exempt from withholding under the treaties through an overseas investment vehicle (“OIV”) is required to submit an application form to the withholding agent
  - **Income exemption from withholding subject to OIV rule**
4. Proposed Amendment to the Tax Act for 2014, cont’d

- Tax exemption on dividend shall be abolished in Free Economic Zone

- Before
  - Withholding tax on dividend income: **Exempt**

- To be amended effective on Jan 2014
  - According to the draft amendment, foreign investors who invest into certain designated area (e.g. Free Economic Zone), tax exemption on dividends will be abolished.
  - **Subject to dividend withholding tax**
5. NTS Audit Directive for 2013

- Focused on the tax avoidance using offshore financial accounts.
- Also tax payers alleged to avoid tax on Koran source income by pretending to be nonresidents.
- Added that nothing under the Treaty will be construed as restricting the application of any provisions of the laws of both countries which are designed to prevent the avoidance of taxes.
- On-going inspection on whether the foreign income recipient is a beneficial owner.
6. OIV rule

- OIV conducting the following activities:
  - Obtaining funds by making offers for investment
  - Acquiring, managing, or disposing of investment assets; and
  - Distributing profits to its investors.

- Look-through principle

- Example of Beneficial Owners
  - Qualifying foreign pension funds
  - Foreign securities depositories with the Korean Securities Depository account
  - OIV deemed as beneficial owners under tax treaties.
6. OIV rule, cont’d

Korean Tax Update

Documentation required

<table>
<thead>
<tr>
<th>Taxpayer</th>
<th>Documentation</th>
<th>Recipient</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>① Application for reduced rate</td>
<td>OIV (HK)</td>
</tr>
<tr>
<td>B</td>
<td>① Application for reduced rate</td>
<td>OIV (HK)</td>
</tr>
<tr>
<td>POIV (Dutch)</td>
<td>① Declaration of OIV ② Documentation to support public OIV status</td>
<td>OIV (Lux)</td>
</tr>
<tr>
<td>OIV (HK)</td>
<td>① Declaration of OIV ② Schedule of beneficial owner</td>
<td></td>
</tr>
<tr>
<td>Pension fund</td>
<td>① Application for reduced rate ② Documentation to substantiate deemed beneficial owner status</td>
<td></td>
</tr>
<tr>
<td>OIV (Lux)</td>
<td>① Declaration of OIV ② Schedule of beneficial owner ③ Declaration received from POIV(Netherlands) and OIV (HK)</td>
<td>WHT agent</td>
</tr>
</tbody>
</table>
### Calculation of average rate

<table>
<thead>
<tr>
<th>Country</th>
<th>Ownership</th>
<th>Reduced tax rate (including resident tax)</th>
<th>WHT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>20%</td>
<td>15%</td>
<td>3%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>50%</td>
<td>(11%*90/100+22%*10/100)</td>
<td>6.05%</td>
</tr>
<tr>
<td>UK</td>
<td>30%</td>
<td>5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td></td>
<td>10.55%</td>
</tr>
</tbody>
</table>

### 6. OIV rule, cont’d

- **A (US)**
  - Dutch Investors: 90%
  - POIV (Netherlands): 20%

- **B (HK)**
  - OIV (HK): 10%
  - Pension fund (UK): 50%
  - 30%

- **OIV Luxembourg**
  - Dividend: 100%

Korean Co
Tax Efficient Holding Structures

Jaedok Lee
Agenda

Section one  LLC Type Real Estate Fund (REF)
Section two  Trust Type REF
Section three  P-REIT
Section four  CR-REIT
Section five  PFV
### LLC Type REF

#### Classification

<table>
<thead>
<tr>
<th>Classification</th>
<th>LLC Type REF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Entity Type</strong></td>
<td>Limited liability company (“Yuhan hoesa”)</td>
</tr>
<tr>
<td><strong>Asset Qualification</strong></td>
<td>At least 50% of the assets should be real estate or real estate-related securities</td>
</tr>
<tr>
<td><strong>Ownership Requirement</strong></td>
<td>At least two investors are required</td>
</tr>
<tr>
<td><strong>Public offer</strong></td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Instruction by Investor</strong></td>
<td>Investor should not be involved in management</td>
</tr>
<tr>
<td><strong>Acquisition Tax</strong></td>
<td>30% reduction from regular acquisition tax of 4.6% upon acquisition by December 31, 2014</td>
</tr>
<tr>
<td><strong>Corporate Income tax</strong></td>
<td>Avoidable through dividend declared deduction</td>
</tr>
<tr>
<td><strong>Capital Gain Tax on transfer of Property</strong></td>
<td>Avoidable through dividend declared deduction</td>
</tr>
</tbody>
</table>

#### Diagram

- **Investors**
- **Capital investment**
- **Trust service**
- **Supervision**
- **Management service**
- **AMC**
- **Asset**
- **Trustee**
- **FSS (*)**

(*) FSS: Financial Supervisory Service

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**Trust Type REF**

<table>
<thead>
<tr>
<th>Classification</th>
<th>Trust Type REF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Entity Type</strong></td>
<td>Trust</td>
</tr>
<tr>
<td><strong>Asset Qualification</strong></td>
<td>At least 50% of the assets should be real estate or real estate-related securities</td>
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<tr>
<td><strong>Corporate Income tax</strong></td>
<td>Not taxable</td>
</tr>
<tr>
<td><strong>Capital Gain Tax on transfer of Property</strong></td>
<td>Not taxable</td>
</tr>
</tbody>
</table>

Trust service: Trustees, Trust Type REF, FSS

Capital investment: Supervision, Registration

Investors: At least 50% of the assets held are real estate-related securities

Asset: Management service, AMC, Acquisition, Trust Type REF, Capital investment

Supervision: Registration

Trustee: Trust service

AMC: Management service

Acquisition: Asset

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# P-REIT

<table>
<thead>
<tr>
<th>Classification</th>
<th>P-REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Entity Type</strong></td>
<td>Stock corporation (“Chusik hoesa”)</td>
</tr>
<tr>
<td><strong>Asset Qualification</strong></td>
<td>At least 70% of the assets should be real estate</td>
</tr>
<tr>
<td><strong>Ownership Requirement</strong></td>
<td>Single shareholder including its related parties is not allowed to hold shares in excess of 40% of total issued shares</td>
</tr>
<tr>
<td><strong>Public offer</strong></td>
<td>At least 30% of total issued shares should be offered to the public</td>
</tr>
<tr>
<td><strong>Instruction by Investor</strong></td>
<td>Investor can participate in management as a shareholder in accordance with the Articles of Incorporation.</td>
</tr>
<tr>
<td><strong>Acquisition Tax</strong></td>
<td>30% reduction from regular acquisition tax of 4.6% upon acquisition by December 31, 2014</td>
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(*) MLIT: Ministry of Land, Infrastructure and Transport

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Diagram:
- Investors ➔ Capital investment ➔ P-REIT ➔ Trust service ➔ Supervision ➔ MLIT (*) ➔ Registration ➔ AMC ➔ Asset

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CR-REIT

Classification | CR-REIT
--- | ---
Entity Type | Stock corporation (“Chusik hoesa”)
Asset Qualification | At least 70% of the assets should be real estate. Seller should repay at least 50% of existing debt with the sales proceeds under corporate restructuring plan. Approval is necessary from Financial Supervisory Service regarding corporate restructuring plan.
Ownership Requirement | N/A
Public offer | N/A
Instruction by Investor | Investor can participate in management as a shareholder in accordance with the Articles of Incorporation.
Acquisition Tax | 30% reduction from regular acquisition tax of 4.6% upon acquisition by December 31, 2014
Corporate Income tax | Avoidable through dividend declared deduction
Capital Gain Tax on transfer of Property | Avoidable through dividend declared deduction
**PFV**

**Classification**

<table>
<thead>
<tr>
<th>Entity Type</th>
<th>PFV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Facility and SOC investments, natural resource development</td>
<td>Stock corporation (“Chusik hoesa”)</td>
</tr>
</tbody>
</table>

**Asset Qualification**

- Facility and SOC investments, natural resource development

**Ownership Requirement**

- Financial institution should be a shareholder of a PFV holding at least 5% of capital

**Public offer**

- N/A

**Instruction by Investor**

- Investor can participate in management as a shareholder in accordance with the Articles of Incorporation.

**Acquisition Tax**

- 50% reduction from regular acquisition tax of 4.6% upon acquisition by December 31, 2014

**Corporate Income tax**

- Avoidable through dividend declared deduction

**Capital Gain Tax on transfer of Property**

- Avoidable through dividend declared deduction

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* MLIT: Ministry of Land, Infrastructure and Transport

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**Diagram:**

- Investor
  - Capital investment
    - Capital investment (5%)
    - Cash management
  - Financial Institution
  - PFV
  - Tax Office
  - Report
  - Management service
  - AMC
  - Acquisition
  - Asset

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Key Ways to Approach to Korean Capital

Ashley Choi
Agenda

Section one  Major players and their needs
Section two  Key ways to approach to Korean capital
1. Major players and their needs

Investor type

- SWF
  - Direct investment
    - (Special tax benefit)
      - (e.g. Section 892)

Pension funds / Institutional investors

- Indirect investment through “Trust”

Preferred structure

Investors’ needs for their investments

- Low risk, stabilized cash flow, and the focused location for investments
1.1 Direct investment structure

Tax Implications

- Special tax benefit (e.g. section 892)

Major issue

- Whether qualification can be satisfied
1.2 Indirect investment structure

**Tax Implications**

- Not taxable entity
- Foreign tax refund

**Major issue**

- How the trust is treated from overseas jurisdiction
  - Transparent vs. Non-transparent
2. Key Ways to approach to Korean Capital

- Relation oriented atmosphere
- Understanding of Korean market
- Well informed of precedent investment structures
- Effective communication