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Via electronic submission to: won8100@mosf.go.kr

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Re: Article 98-6 of the Corporate Income Tax Law and Draft Presidential Decree Article 138-7, Special Cases of Tax Withholding Procedures for Application of Reduced Tax Rates pursuant to Double Tax Treaties for Foreign Corporations

Dear Sir:

We write on behalf of the Association of Global Custodians (the "Association")¹ to convey Association members' views and concerns in respect of the recently revised Article 98-6 of the Corporate Income Tax Law ("CITL") relating to withholding tax procedures for claiming reduced rates of tax pursuant to double tax treaties, and the draft Presidential Decree for implementing those procedures (the "draft Decree").

As you may know, in providing global custody services, Association members routinely seek appropriate tax relief on behalf of their custody clients. The Association also works to eliminate or minimize existing discrepancies in the current tax relief processes and regimes from jurisdiction to jurisdiction, which can be problematic and

¹ The Association is an informal group of 11 member banks that provide securities safekeeping and asset-serving functions to cross-border institutional investors worldwide. Members provide custody-related services to most types of institutional investors, including investment funds, pension funds, and insurance companies. Members participate in all CSDs around the globe either directly or through subcustodians and as such have considerable interest in safe, effective, and efficient CSD operations. Association members are listed on the letterhead above.

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costly for custodians and their clients. Thus, our members take a great interest in the withholding tax procedures utilized in the jurisdictions around the world where they conduct custody activities, and we therefore greatly appreciate the opportunity to comment on the proposed procedures in Korea.

As an initial point, we understand the forces that drive governments to implement procedures for claiming treaty relief from withholding tax on cross-border investment income. Indeed, Association members are of the view that properly designed and well-publicized procedures can contribute to the smooth operation of a treaty relief system. Thus, our members do not question the basic objectives of the recent revision to Article 98-6. Moreover, a review of the draft Decree suggests that the Korean Government is making sincere efforts to implement the new procedures in a way that will minimize the burden and expense of compliance on the part of investors and the financial institutions through which they hold their investments. We commend those efforts.

Association members do, nevertheless, have a number of questions and concerns about the draft Decree, as explained below. We note that, to date, we have been able to obtain only an unofficial English translation of Article 98-6 and the draft Decree, so we may have additional comments if we discover that our understanding of their provisions is inaccurate. As explained further below, our questions and comments relate to:

1. The need for clarification of the term “real beneficial owner”.
2. The need for an early release of the “Application for Reduced Withholding Tax Rates” form and for possible deferral of the effective date of the new procedures.
3. The suggestion to conform the “Application for Reduced Withholding Tax Rates” form with the Investor Self-Declaration developed by the OECD as part of the Treaty Relief and Compliance Enhancement (“TRACE”) project.
4. The need for clarification of the term “OIV”.
5. The need for early release of the “OIV Confirmation Report” and accompanying guidance.
6. The suggestion to model the OIV Confirmation Report on the TRACE Investor Declaration form.
7. The suggestion to lengthen the validity period for the forms to 5 years, to conform with TRACE.
8. The recommendation to eliminate the need for OIVs such as large custodian banks to attach information about specific investors to any OIV Confirmation Report, or at least to require updating of such information only on a periodic basis.

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9. The need for clarification as to the criteria that would exclude OIVs from the exemption from the requirement to attach beneficial owner information to the OIV Confirmation Reports.
10. The need for clarification as to the treatment of OIVs that are eligible for that exemption.
11. The need to clarify the standards by which foreign pension funds, nonprofit organizations, and OIVs resident in treaty countries can qualify for treatment as beneficial owners and the documentation requirements applicable for that purpose.
12. The suggestion to clarify the documentation requirements applicable to tax refund claims and to provide a procedure whereby withholding agents could file such claims on behalf of investors.
13. The suggestion to give priority to the objectives of the OECD's TRACE project in making further decisions about the introduction of new withholding procedures.

For your reference, the section headings below refer back to these numbered issues).

I. Clarification of the Application Form Template and Supplementary Documentation Requirements (Issues #1 - #3)

Association members understand that under the draft Decree, a foreign investor (the "real beneficial owner") who receives Korean source income directly from a Korean withholding agent (e.g., a local custodian) will be required to submit an "Application for Reduced Withholding Tax Rates" to the Korean withholding agent prior to the date when the income is paid in order to benefit from the application of a reduced treaty rate of withholding at source. Members suggest that it would be very helpful for the National Tax Service ("NTS") to provide guidance clarifying the meaning of the term "real beneficial owner".

The Association also notes that the template for the form, "Application for Reduced Withholding Tax Rates", is not yet available. It is critical that this form be released as soon as possible, so that financial institutions can begin the process of contacting their investor clients who need to complete the form, explaining to them the form's requirements, and ensuring that the forms are completed, returned, and forwarded to the relevant Korean withholding agents before the first payments to be made after the July 1, 2012 proposed effective date. Indeed, with just over five months to go before the new procedures are to take effect, the timing for that process is already extremely (and quite likely unrealistically) tight. Moreover, if there are any supplementary documentation requirements that will need to be met in addition to completion of the form itself, those need to be announced at the same time the form is released.

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If, as we understand may be the case, the form is not released before late March, Association members would strongly urge the NTS to delay the effective date of the new procedures for several months. We note that delays in the publishing of this form will result in investors being unlikely to comply within the tight timelines and therefore being likely to lose benefit of the tax treaty at the time of income payment. This will result in an increase in the number of tax reclaims, which would impose additional burden and cost on both the Korean tax administration and the investor.

The Association is also aware that Korea has been an active participant in the OECD's Treaty Relief and Compliance Enhancement ("TRACE") project. Association members fully support the goals of that project to improve countries' procedures for claiming reduced treaty rates of withholding, and in particular the objective for countries to standardize their treaty withholding tax procedural requirements, using the elements of the Implementation Package which has been developed in close consultation between participating governments and the business community.² The Association commends Korea for proposing that treaty relief be applied on the basis of a form which appears to be a kind of self-declaration by investors, since that approach is one of the key recommendations to emerge from the OECD's work.

In that respect, given the substantial amount of thinking, discussion, and effort which, over the past several years, has gone into developing the "Investor Self-Declaration" ("ISD") form as part of the OECD Implementation Package, the Association strongly recommends that Korea follow the ISD form in preparing its "Application for Reduced Withholding Tax Rates" form. It would be regrettable indeed if Korea were to adopt a form which was inconsistent with the template developed by the OECD, as that would undermine the benefits intended to be realized by governments and investors alike from using a standardized form. Adoption of a non-OECD-compatible form by Korea would be particularly unfortunate at this stage, when the TRACE project is entering its implementation phase, as it would hamper Korea's ability to participate with other countries in the "Authorised Intermediary" regime proposed by the OECD or would, at the very least, make transition to that regime more burdensome and expensive for both Korea and its investor community.

II. Definition of Offshore Investment Vehicle (OIV) (Issue #4)

Article 98-6 prescribes special rules for claiming treaty relief on payments of Korean source income made through an "Offshore Investment Vehicle" ("OIV") as defined by Presidential Decree. We understand that the draft Decree would define OIV rather broadly to mean an organization established outside of Korea which solicits money from investors and manages the funds by investing in valuable assets, including

² The OECD released the draft Implementation Package in February 2010 (see <http://www.oecd.org/dataoecd/20/36/44556378.pdf>), and the OECD TRACE Group has continued to refine the elements of that package in consultation with the TRACE Business Advisory Group.

but not limited to purchases and sales of such assets and the distribution of profits therefrom to such investors.

To increase certainty regarding the applicability of the special documentation requirements to foreign investment vehicles, Association members recommend that the Ministry of Strategy and Finance (“MoSF”) clarify through the CITL or the draft Decree itself the types of foreign investment funds that meet the definition of OIV (e.g., various domiciles of mutual funds, investment trusts, corporate form funds, etc.). Alternatively, the NTS may need to review and determine on a case-by-case basis whether a particular foreign investment vehicle qualifies as an OIV, which would create further uncertainty regarding the applicability of the new documentation requirements and hinder the predictability of the treaty benefits availability.

III. Withholding Tax Relief Procedures for Income Paid to OIVs (Issues #5 - #11)

Association members understand that the draft Decree sets forth different documentation requirements, depending on whether income is paid through an OIV and, if so, on the nature of the OIV. We describe below our understanding of the proposed requirements and provide comments thereon.

Subject to certain exceptions mentioned below, foreign investors who receive Korean source income through an OIV will be required to submit the “Application for Reduced Tax Rates” form to the OIV in order for reduced treaty rates of withholding to be claimed with respect to that income. Unless the OIV satisfies certain conditions, also described below, the OIV must in turn submit to the withholding agent, prior to the date of payment of the income, an “OIV Confirmation Report” to which it must attach a document containing details of the beneficial owners claiming treaty relief.

If the OIV satisfies three conditions, it is our understanding that it need not collect or submit to the withholding agent the “Application for Reduced Tax Rates” form from its investors, but instead need only submit to the withholding agent an “OIV Confirmation Report” together with “relevant verifying documents”. We understand the three conditions to be the following:

1. The OIV is regulated by the financial supervisory authorities of the Contracting State party to the relevant tax treaty in order to ensure transparency and independence of its business activities;
2. The number of investors in the OIV on each business day during the immediately preceding fiscal year is not less than 100 on average; and
3. The OIV is not on a list of OIVs which are excluded from treaty benefits under the relevant tax treaty.

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It appears from the draft Decree that OIVs that satisfy these three conditions and that provide to the withholding agent an "OIV Confirmation Report" together with "relevant verifying documents" can claim treaty benefits in their own names, without regard to the identity of their beneficial owners.

In addition, the draft Decree indicates that there are three categories of special entities which will be treated as beneficial owners of income eligible for treaty relief:

1. Pensions established in foreign countries under laws equivalent to Korea's National Pension Law, Public Officials Pension Law, Veterans' Pension Law, Pension for Private School and Staff Law, Employee Retirement Benefit Security Law, etc.;
2. A fund which does not distribute profits to its members and which qualifies as a nonprofit organization established under the laws of the Contracting State party to the relevant tax treaty; and
3. An OIV which is set out under the relevant tax treaty as being acknowledged as a resident of the Contracting State party to treaty.

We understand that entities falling within any of these three categories may submit the "Application for Reduced Treaty Rates" form in their own name as beneficial owners.

Association members have the following questions and comments regarding these proposed procedures.

A. OIV Confirmation Report (Issues #5 - #6)

The NTS should announce the content, purpose, and format of the "OIV Confirmation Report" as well as the document containing details of the beneficial owners as soon as possible. Indeed, it would be desirable for the NTS to release drafts of these documents and their instructions before they are finalized, in order to give affected persons an opportunity to submit comments and questions in relation to them. Not until Association members have had an opportunity to review the draft documents will they be able to provide detailed suggestions or questions in relation to them.

Association members note, however, that the proposed OIV Confirmation Report seems to be somewhat similar to the "Intermediary Declarations" which are part of the OECD's proposed Implementation Package from its TRACE project, except that the OIV Confirmation Report appears to require, in certain cases, an attached document with beneficial owners' detailed information, rather than a "Tax Rate Information" statement specifying pools of investors (as in the case of TRACE's "Intermediary Declaration – Authorised Intermediary") or an attached copy of each investor's self-declaration (as in the case of TRACE's "Intermediary Declaration – Contractual Intermediary"). Subject to that difference, to the extent that the NTS can make the OIV Confirmation Report

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consistent with the proposed TRACE Intermediary Declaration forms, Association members recommend that it do so.

***B. Documentation Validity Period / List of Beneficial Owners
(Issues #7 - #8)***

The draft Decree provides that the “Application for Reduced Withholding Tax Rates” form and the “OIV Confirmation Report” will remain valid and need not be renewed for 3 years from the date of their first submission, subject to the requirement that details of any change in their content be submitted to the withholding agent between the date of the change and the date of the first payment of Korean source income thereafter. The Association supports the concept of a multi-year validity period for these documents, but Association members have a few comments in this regard.

First, members note that the OECD’s draft Implementation Package for the TRACE projects recommends a 5-year validity period for Investor Self-Declarations (and an indefinite validity period for Investor Self-Declarations with respect to a government -- (including a central bank of issue, agency or instrumentality -- or an international organization). Association members suggest conforming the validity period for the “Application for Reduced Withholding Tax Rates” form with the OECD ISD validity period in order to support the TRACE project objective of harmonizing procedural requirements to improve efficiency and reduce burdens.

Second, Association members seek clarification as to whether the “OIV Confirmation Report”, including any attached list of beneficial owners, will also remain valid for 3 years, or whether it would be necessary under the draft Decree to update that combined submission whenever there is any change to the list of beneficial owners.

Members note that documentation requirements which involve frequent updating can become very burdensome and costly in the case of intermediated investment structures through which large and frequently-changing groups of investors hold their investment assets. This problem was very much the focus of the OECD work which has evolved into the TRACE project. For example, in the case of collective investment vehicles (“CIVs”), the January 2009 report issued by the OECD described the substantial difficulties CIVs face in keeping constant track of their regularly-changing investor base:

Interests in CIVs acquired through intermediaries often are registered at the CIV level through nominee/street name accounts. One reason for this is competitive — intermediaries view customers’ identities as highly valuable proprietary information. Another reason is efficiency — intermediaries aggregate their customers’ purchases and sales each day and effect only a net purchase or a net sale each day in the nominee account. Whilst investments in a CIV are typically long-term, a CIV’s shareholder base may change every day, as new shares are issued and existing shares are redeemed (or as shares trade on an

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exchange). Because of nominee accounts, the CIV's manager may not be aware of changes in its underlying investors.³

While the draft Decree's treatment of various publicly offered OIVs as exempt from the requirement to provide lists of underlying beneficial owners may help to alleviate this problem for many CIVs, the need to generate constantly updated lists of investors is also a serious problem for large non-CIV financial intermediaries, such as Association members. Indeed, this was one of the primary factors that led to the OECD's proposal to develop the Authorised Intermediary regime now being refined through the TRACE project. The complexity of the typical cross-border portfolio investment holding structure, including multiple layers of intermediaries and the use of omnibus accounts, is described in detail in a second OECD report from January 2009, which explained how the cost of burdensome procedures could result in treaty benefits simply going unclaimed:

Although the vast majority of publicly traded securities is now held through a complex network of domestic and foreign intermediaries, few countries have adapted their withholding tax collection and relief procedures to recognize this multi-tiered holding environment. If systems are based on the implicit assumption that there is a direct relationship between the issuer (or its local paying agent) and the beneficial owner of income, it may be difficult or impossible to make an effective claim for treaty relief because of the reality of intermediated financial structures. Tax procedures that are too burdensome, such as requiring laborious and costly transmission of detailed paperwork up and down chains of intermediaries to achieve treaty benefits, are unlikely to be followed.⁴

Association members understand that Korea is contemplating adopting the OECD's proposed Authorised Intermediary regime, which would provide a streamlined, workable, and internationally endorsed procedure for treaty claims to be made through financial intermediaries. In the interim, the Association would urge Korea to refrain from introducing any requirements which would make it virtually impossible for treaty claims to be made in a cost-effective way for investments held through large financial intermediaries. In this respect, Association members recommend that the otherwise applicable requirement to provide lists of beneficial owners should not apply to large financial intermediaries (e.g., banks with aggregate assets in excess of \$ US 100 billion held in custodial accounts), who should instead be able to submit summary information

³ *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on the Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles*, OECD, 12 January 2009, paragraph 16, available at <http://www.oecd.org/dataoecd/34/26/41974553.pdf>.

⁴ *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on Possible Improvements to Procedures for Tax Relief for Cross-Border Investors*, OECD, 12 January 2009, paragraph 10, available at <http://www.oecd.org/dataoecd/34/19/41974569.pdf>.

to withholding agents about the percentage of investors who qualify for treaty relief, and to update that information only at reasonable intervals (e.g., not more frequently than annually). As a less preferred alternative, such intermediaries should be allowed to update on a 3-year cycle the list of beneficial owners attached to any OIV Confirmation Report they need to file.

C. OIVs Exempt from the List Requirement (Issues #9 - #10)

Among the three conditions which an OIV must meet to qualify for exemption from the requirement to submit a list of beneficial owners is the requirement that the OIV not be on a list of OIVs excluded from treaty benefits under the relevant tax treaty. Association members believe it would be helpful if the draft Decree clarifies that the type of exclusion provision referred to here is one that specifically names a category of investment fund established in the relevant Contracting State and states that income paid to such a fund will not be eligible for treaty benefits. Treaty provisions should not be deemed to exclude an OIV from this exemption if they are more general in nature (e.g., if their purpose is to ensure that treaty benefits are available only to a “person”, a “resident”, a “beneficial owner”, or a non-fiscally transparent entity). Particularly given common legal uncertainty about whether such general treaty provisions operate to exclude OIV-type entities from treaty benefits,⁵ it will be critical for the draft Decree to clarify that such general treaty provisions will not prevent an OIV from qualifying for the exemption.

In addition, Association members suggest that the draft Decree clarify that OIVs qualifying for this exemption are allowed to claim treaty benefits in their own name, and that there will be no look-through to the underlying investors in such entities, with the result that such entities have no obligation to collect documentation from those investors for Korean tax purposes.

D. Pension Funds (Issue #11)

The Association commends Korea for including in the draft Decree a provision aimed at allowing foreign pension funds to claim treaty benefits in their own right as beneficial owners. Association members note, however, that it will be important to have legal certainty as to the categories of funds which will qualify for this treatment. The draft Decree’s reference to pension funds which are established under a foreign law equivalent to certain Korean pension fund authorizing legislation does not provide adequate certainty, particularly given the history of difficulties in ascertaining whether such criteria are met under certain other countries’ laws. Therefore, the Association recommends that the draft Decree clarify whether the “equivalence” test can be applied broadly, and/or that it specify the basic features of the Korean pension fund authorization

⁵ See the OECD *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on the Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles* referenced above.

legislation which should also be found in the foreign law. It is further recommended that the NTS indicate whether it will be prepared to issue rulings on foreign funds' qualification for this treatment.

It would also be useful if the draft Decree could specify, in particular, what type of verifying documentation, if any, would have to be submitted to a Korean withholding agent by a foreign pension fund hoping to qualify for this treatment. Also, if there is any need for that documentation to include any kind of certification from the pension fund's home country governmental authorities, Association members' experience confirms that it often takes a considerable period of time to obtain such certifications. Accordingly, the Association recommends that no such certifications be required, or in the alternative that the effective date for the requirement of such certifications be pushed back until at least 1 year after the requirement is published.

E. Nonprofit organizations (Issue #11)

As with the pension funds, the Association commends Korea for including in the draft Decree a provision to allow nonprofit organizations to qualify as beneficial owners in their own right. The Association recommends, however, that further clarification, along the lines of that suggested above for pension funds, be included in the draft Decree.

F. OIVs Treated as Beneficial Owners (Issue #11)

The Association also commends Korea for specifying at paragraph 5(c) of the draft Decree that an OIV may claim benefits as a beneficial owner if it is defined as a resident of the treaty country in the relevant tax treaty. As we understand this language, it would appear to include any fund which satisfies a treaty's generic standard for residence, typically found in Article 4 (e.g., this is the standard on which U.S. regulated investment companies typically rely to claim treaty benefits as residents of the United States). Some readers, however, have understood the draft Decree's criterion more narrowly to cover only a treaty provision which refers specifically to a certain category of investment fund. Association members urge the MoSF to clarify that members' reading of the draft Decree is correct.

Also, as with pension funds and nonprofit organizations, the Association suggests that the draft Decree specify in some detail the type of verifying documentation, if any, which a qualifying OIV will have to submit to Korean withholding agents, and further suggests that the draft Decree ensure adequate time for that documentation requirement to be satisfied before the new withholding procedures take effect. Association members further suggest that the draft Decree clarify whether an OIV qualifying for this treatment should submit to the withholding agent an "Application for Reduced Withholding Tax Rates" form or an "OIV Confirmation Report".

IV. Tax Reclaim Procedure (Issue #12)

We understand that the draft Decree indicates that where a withholding agent has not received valid documentation prior to the payment date, it must withhold tax at the statutory tax rates, although paragraph 4 of Article 98-6 provides that a tax refund may be claimed within the following 3 years. The draft Decree does not provide details on the procedures to be followed in filing such a refund claim, nor is it clear whether any documentation is required from the investor other than the “Application for Reduced Tax Rates” form which could be used to claim relief from withholding at source. Some commentators have suggested that investors may be required to submit a Certificate of Residence from their home country tax authorities with such a refund claim. Association members urge the MoSF to clarify that no such additional documentation will be required at the refund claim filing stage, and that the same form used to claim withholding tax relief at source may be used to claim a refund of withholding tax.

Association members also suggest that the NTS implement a procedure whereby local withholding agents (e.g., local custodian banks) may file tax reclaims on behalf of foreign investors in situations where the withholding agent receives the required documentation after the payment date. Such local withholding agents are likely to be familiar with the procedures for filing such claims, and allowing them to handle the refund claim process for the foreign investor would eliminate the latter’s need to engage local counsel to assist with the refund claim. The cost of engaging local tax counsel would often outweigh the potential benefit of the refund to the foreign investor and hence effectively act as a barrier to legitimate treaty claims. Furthermore, given the tight timelines for investors to provide the “Application for Reduced Withholding Tax Rates” form and “OIV Confirmation Report”, we anticipate a marked increase in the number of tax reclaims submitted to the Korean tax administration.

V. Coordination with the OECD Trace Group (Issue #13)

The Association commends Korea for its participation in the OECD’s TRACE project. Association members have also been active in that project through the business advisory group, and members view the work done by the TRACE Group as highly valuable and well-designed to meet the OECD’s objective of developing proposals to improve the procedures for claiming treaty benefits on cross-border portfolio investment income and thereby to eliminate unjustifiable hurdles to legitimate claims for treaty relief.

After six years of hard work at the OECD, the TRACE project is now moving into its implementation stage, as governments begin the serious process of analyzing the steps needed in their individual countries to achieve implementation and initiating those steps. It would be ironic indeed and regrettable if any government actively participating in the TRACE Group were to institute procedures at this juncture which would conflict with the TRACE Group’s recommendations and which would have the effect of making the procedures for claiming treaty relief more onerous. The Association members respectfully suggest that introducing potentially burdensome new documentation requirements which are inconsistent with the TRACE recommendations (e.g., constantly

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documenting to withholding agents the identity and other details about specific investors who form part of a large and frequently changing pool, without offering the safety valve of the Authorised Intermediary regime) would be a step in the wrong direction and would send an unfortunate signal relative to the TRACE project. We therefore urge the MoSF to give priority to the recommendations of the TRACE Group in making its decisions about new withholding tax relief procedures in the foreseeable future.

* * * * *

The Association very much appreciates the opportunity to comment on the draft Decree. If you would like to receive a Korean translation of this letter, please let us know and we will endeavor to provide that to you. Industry reliance on information provided by national tax administrations, whether through circulars or public rulings, is of fundamental importance in the ongoing administration and application of tax treaties. As you appreciate, members have a general concern regarding the details and tight deadlines of the new regime and its potential to disrupt both current and future investment decisions by portfolio investors. We would welcome any future opportunities to work with you with respect to the implementation of a functioning system. Should you have any questions regarding this submission, please contact the undersigned.

Sincerely yours on behalf of the Association,



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Secretariat and Counsel to the Association

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