Press Release by the National Tax Service

* Please use the following language for the press release beginning with the morning paper on September 30, 2005 (Friday):

Results of Tax Audits on Income Earners Who Underreported Income Illegally

☐ Coinciding with the inauguration of Commissioner Ju Seong Lee, the National Tax Service ("NTS") has concentrated its investigations on ferreting out and eliminating acts of tax evasion that have been going on in our society for an extended period of time. As a result, the NTS has collected an aggregate amount of KRW 670 billion in additional taxes through tax audits of foreign funds, income earners who underreported income illegally and speculative real estate activities, etc.

☐ As part of these efforts, the NTS has accused a total of 10 persons of tax avoidance, and has reported another 76 persons to the relevant authorities for violations of related laws and regulations, such as the Foreign Exchange Controls Law.

☐ Background

☐ In accordance with the basic principle that to achieve fair taxation in an open economic system, where there is no practical purpose for distinguishing domestic capital from foreign capital, there must be strict enforcement of tax laws without discriminating against domestic or foreign capital.

- The NTS has performed tax audits on some of the foreign funds that it has suspected of avoiding taxes after having generating huge amounts of income in Korea.

☐ In order to deal with those persons who have underreported income illegally, which unfairly shifts the tax burden to honest taxpayers and threatens the sound economic order, and to restrict speculation in real estate, the NTS has also concentrated its enforcement of tax laws on performing tax audits on those who engage in speculative real estate activities.

☐ On the other hand, the NTS has minimized to the extent possible tax audits on most other taxpayers, who honestly file their tax returns on a regular basis, to promote the honest filing of tax returns. As a result, the NTS has conducted tax audits against honest taxpayers in moderation by excluding them from the performance evaluations.
The NTS shortened the tax audit period to the extent possible by introducing a documentary and advisory audit system. The NTS has also established and aggressively promoted measures to prevent any wrong imposition of taxes.

The NTS endeavors to satisfy the nation's desire for equal and uniform taxation by subjecting tax evaders to tax audits more frequently than honest taxpayers.

Subject of tax audit and the status thereof

Concerning the tax audit on foreign funds

Since auditing two (2) foreign funds beginning April 12, 2005, the NTS has been auditing four (4) additional foreign funds. Out of the six (6) foreign funds in total, the NTS has completed tax audits on five (5) funds, with one tax audit currently pending.

[Translation omitted]

Audit results and assessments

Results of tax audit on foreign funds

The NTS collected KRW 214.8 billion in additional taxes after completing its tax audits on 5 out of the 6 aforementioned funds.

Results of tax audits by type of tax avoidance

<table>
<thead>
<tr>
<th>Main types</th>
<th>Additionally collected tax amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>2,148</td>
</tr>
<tr>
<td>• Avoidance of taxes (i) by taking advantage of tax havens in investing in domestic companies and (ii) by abusing tax treaties. (Application of the substance over form principle)</td>
<td>1,473</td>
</tr>
<tr>
<td>• Transfer of domestic income to foreign related parties through the payment of interest at unreasonably high interest rates</td>
<td>302</td>
</tr>
<tr>
<td>• Failure to file securities transaction tax returns</td>
<td>373</td>
</tr>
</tbody>
</table>
The NTS will notify the Financial Supervisory Service ("FSS") of violations of finance-related laws through unlawful and unfair transactions; and

- The NTS will determine whether to refer cases involving alleged tax crimes to the Prosecutor's Office after closely reviewing whether certain acts constituted tax avoidance through "fraudulent or other illegal acts" under the Tax Crime Punishment Act.

[Translation omitted]

Future Plan

- The NTS will continue its efforts to establish a transparent society through its ceaseless efforts to crack down on recurring tax evasion in order to achieve fair taxation as well as ensure proper tax compliance; and

- continuously concentrate its efforts especially on rooting out speculation in real estate, which is contrary to the country's well-being, by tracing any speculation income all the way up the chain.

In addition, NTS will strengthen its efforts to enhance the transparency of economic activities and taxation through the application of fair tax policies without distinguishing between domestic and foreign capital, in conformity with the standards of international taxation.

- It is expected that NTS' tax audits at this time will enhance the transparency of foreign capital investment flow into Korea and the distribution of income thereof, ultimately having a positive effect on inducing foreign capital.

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Reference

Major Audit Cases

Case 1. With respect to an act of unfairly abusing the tax treaty, NTS has imposed taxes on the person to whom the income is in substance attributable through the application of the substance-over-form principle under domestic tax law.

Details of Transactions and Factual Background

- Y Ltd. in Country B ("Y Ltd."), which X Fund in Country A ("X Fund") established, acquired OO building (the "Building at Issue") owned by a domestic real estate corporation, a Corporation Z ("Corp. Z"), through the purchase of 100% of its shares.

- After the acquisition of the Building at Issue, the market price of domestic real estate skyrocketed. Accordingly, Y Ltd. realized a huge amount of capital gains through the subsequent transfer of 100% of its shares in Corp Z.

Details of the Tax Audit

- Despite the considerable difficulty in conducting the tax audit due to X fund's delayed submission of relevant information requested by the NTS,

  - The NTS conducted a detailed tax audit through a close review of internal documents found during the audit process, on-site
inspections, interviews with the personnel involved, tracking the funds flow, etc.

As a result, the NTS confirmed that Y Ltd. in Country B which invested in Korea is a conduit company established for the purpose of tax avoidance with respect to the income derived from the transfer of the Building at Issue.

Please note that a conduit company is a company established for the single purpose of tax avoidance that does not have control over nor manages the actual income and assets of the invested company.

Further, the NTS confirmed that X Fund in Country A prepared schemes to avoid taxes and conducted the planned activities several times during the period from the pre-share acquisition stage with respect to the shares in Corp. Z and the Building at Issue until the subsequent share transfer stage.

Moreover, the NTS confirmed that Y Ltd. in Country B is not actually involved in the process of acquiring, managing and transferring the shares of Corp. Z which owned the Building at Issue. In addition, Y Ltd. in Country B did not conduct any reasonable business activities nor did not have the ability to manage its own assets. Considering this, the NTS concluded that Y Ltd. is not qualified for tax benefits under the tax treaty between Korea and County B.

The NTS confirmed that X fund was in substance the contracting party to the agreement for the purchase of the Building at Issue, and remitted the purchase price directly from Country A after raising the necessary funds.

The NTS also confirmed that the legal advisor, partner and its domestic subsidiary of X Fund in Country A, rather than Y Ltd. in Country B, were involved in the transfer of the shares in Corp Z and the Building at Issue.

Audit results and assessments

With respect to abuse of the tax treaty

The NTS assessed income tax to the actual income earner through the application of the tax treaty between Korea and Country A and the substance-over-form principle under the domestic tax law, but denying the application of the tax treaty between Korea and Country B.
Case 2. Tax assessment on transfer pricing issues arising from the payment of interest to a foreign related party at an interest rate higher than the arm’s length rate

Transaction flow

- Fund Y (Country A) 100% investment → Company X (Country B)
- 100% investment → Domestic Subsidiary

Loan Interest rate 00%
Payment of interest (Exemption of tax on interest income)

Details of the Tax Audit

- Company X, a subsidiary of Fund Y in Country A, is established in Country B where interest income paid from Korea is exempt from income tax.
- Fund Y was able to have the Domestic Subsidiary obtain loans necessary for its domestic subsidiary through a domestic bank at a low interest rate.
- However, Fund Y had the Domestic Subsidiary obtain loans at a high interest rate through Company X in Country B in an indirect manner for the purpose of procuring an early return on its investment and reducing its tax burden. As a result, the income derived by the Domestic Subsidiary was unfairly transferred to a foreign country.

Audit Results and Assessments

- Selecting the interest rate to be applied by domestic banks to the Domestic Subsidiary as the comparable rate, the NTS determined the arm’s length rate by applying the CUP method after making reasonable adjustments (adjustments for differences in timing of the issuance date, etc.) for the above-mentioned interest rate.
- The NTS imposed tax on the difference between the arm’s length rate and the high interest rate applied to the Domestic Subsidiary, as mentioned above.
Case 3. Diverting of corporate funds into a foreign country through a fictitious service contract

Transaction Flow

1. Consulting contract (fictitious)
2. Loan of $1.84 M
3. Remittance of $1.84 M
4. Remittance of $1.99 M to Korea
5. Repayment
6. Collection of $1.84 M

Company A
(Korea)

Company B
(Korean affiliate of Company A)

Company C
(Hong Kong)

Companies V, W, X, Y, and Z
(Korean subs. under the control of Company B)

General Manager
Used the funds remitted to his personal account (in Korea) to purchase a house, etc.

Details of Tax Audit

A general manager X ("X"), engaging in the general management of domestic companies such as Company A and Company B as well as Companies V, W, X, Y, and Z, established a paper company C ("Company C") in Hong Kong with himself and his wife as the joint shareholders. Afterwards, X had Company C and Company A enter into a fictitious consulting service agreement.

In an attempt to cover up the fictitious contract, X, the actual owner of Company C in Hong Kong, used the name of a Third Party as the signatory to the contract.

A domestic company, Company A, without sufficient funds, borrowed $1.84 million from one of its related parties, Company B, and remitted the proceeds to Company C in Hong Kong. Afterwards, X had its domestic subsidiaries such as V, W, X, Y and Z record fictitious expenses and used so-created funds in repaying the borrowing from Company B. In this manner, Company A diverted corporate funds into a foreign company under this scheme.

All the companies such as Company A, B, V, W, X, Y, and Z are related parties under X's control, and X tried to hide the above-
mentioned transactions through the use of complicated accounting treatment. This treatment was possible since Company B was involved in such services as the management of assets and accounting matters for the other related parties.

As a result, it took a lot of time for audit personnel to find out facts by confirming the identity of the shareholders of Company C, tracing X's bank accounts and conducting interview with persons involved with X.

- X departed from Korea after disposing of his properties and bank accounts in Korea and remitting the funds derived from these dispositions abroad at an early stage of the tax audit.

Audit Results and Assessment

- The NTS denied the deductibility of the fictitious consulting expenses accounted for by the domestic subsidiaries, Companies V, W, X, Y and Z, and accused X of tax evasion based on the NTS' belief that the consulting services were not actually provided. Moreover, the NTS plans to inform the Prosecutor's Office about X's suspected embezzlement and money laundering activities.
Case 4. Underreporting of Domestic SPC Income and Diverting of Foreign Currency

Transaction Flow

Details of the Tax Audit

SPC ("Company A") transferred the bonds of Company Y to an unrelated party, Company B, at a price lower than the fair market price.

- Company B transacted based on a contract whereby Company B would purchase the bonds of Company X from Company A's foreign related party, Company C, at a higher price using the gains derived from the foregoing purchase.

- Company B, a third party, merely lent its name and purchased the bonds of Company X and Company Y at the instruction of the asset manager of the SPC. In exchange for lending its name, Company B had the opportunity to purchase bonds at a lower price, which the asset manager of the SPC provided.

- Through the use of its superior operational position which an asset manager can enjoy, among the normal purchase price payable by Company B to Company A, the Company transferred the difference between the normal price and the actual price to its overseas related party, Company C.

- As a result, the corporate income tax payable by Company A was evaded and foreign currency flowed out to a foreign country.

Audit Results and Assessment

- The NTS collected the relevant underpaid tax amounts and plans to inform the Prosecutor's Office and the Financial Supervisory Service of such illegal acts involving the SPC.
Case 5. Transfer of income through the failure to receive consideration for services provided to the parent company

Details of Transaction and Factual Background

A domestic corporation A ("Company A") is involved in collecting and analyzing information and providing business consulting services to a foreign company B ("Company B") with respect to the latter's investments in Korea.

In consideration for generating investment returns through investments in the domestic corporation, Company B received a considerable amount of incentives from the overseas investor. However, Company B recorded the entire amount of such incentives as income derived by Company B (the parent company).

Audit Results and Assessment

The NTS conducted a detailed tax audit based on evidence that it collected, such as investment and performance reports in Korea, work flowchart and regulations, various kinds of agreements, etc., to recalculate the income attributable to Company A from the performance of services in Korea, among the incentives that Company B, its parent company, received from the foreign investor and imposed taxes based on such transfer pricing adjustment.