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By Electronic Delivery

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RE: *Administrative Obstacles Effectively Preventing CIVs from Receiving Tax Treaty Relief*

Dear Mr. Han and Mr. Jung:

The asset management and banking associations signing this letter are writing to express our profound concerns with the administrative requirements now being imposed on non-Korean collective investment vehicles ("CIVs") seeking to claim treaty benefits. Considerable confusion regarding these requirements has arisen as well; the lack of clear administrative guidance regarding the requirements' application has resulted in CIVs receiving inconsistent information from different Korean subcustodians. The new requirements (and the resulting confusion) are so burdensome, we submit, that CIVs effectively are being denied the ability to claim treaty benefits (1) that they are entitled to receive directly or (2) for which they are making claims on behalf of their investors; these "indirect" claims are made only when the CIV is not treaty-entitled and the only practical approach for investors to receive benefits is indirectly, through the CIV.

This letter describes our concerns and suggests possible approaches for addressing them. We would be pleased to follow up with you at your convenience.

Background – OECD Report on Granting Treaty Benefits with Respect to Income of CIVs

The difficulties faced by CIVs in receiving treaty benefits to which they or their investors are entitled were considered closely during an extensive consultation between governments (including the Korean government) and business at the Organization for Economic Cooperation and Development ("OECD"). The result of this extensive consultation was a report "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" (the "CIV Report")[1] that was approved by the OECD's Committee on Fiscal Affairs in April 2010. The CIV Report's recommendations then

[1] http://www.oecd.org/dataoecd/59/7/45359261.pdf.

were included in the 2010 Update to the Commentary on Article 1 of the Model Convention (the "Model Convention Commentary").[2] This Report and the Model Convention Commentary inform our views regarding the paramount need for certainty regarding treaty eligibility and administrable rules for receiving treaty benefits to which the CIVs or their investors are entitled.

CIV Background

Before discussing the difficulties faced by CIVs in claiming treaty relief, it is useful first to review how CIVs operate, how they are distributed, who are their investors, and what are their investors' rights with respect to CIVs' income and assets. The CIVs with which we are concerned, and which are the subject of the CIV Report, are those funds that are widely held, hold a diversified portfolio of securities, and are subject to investor-protection laws in the country in which they are organized.

CIVs typically are offered publicly through distributors with a local clientele. Many CIVs are registered for sale, and distributed, only in the country in which they are organized; these CIVs generally have essentially 100 percent "home-country" investors.[3] Other CIVs are offered either regionally (such as throughout Europe) or globally; while these CIVs may have extensive distribution networks, the distributors of publicly-offered CIVs that operate within each country typically also have a local clientele.

CIVs generally have many thousands (often tens or hundreds of thousands) of investors; these investors often buy or sell CIV interests either directly from the CIV sponsor or, more likely, from an unaffiliated distributor. CIV units acquired through unaffiliated distributors often are held in a nominee (or "street name") account in the name of the distributor. As noted in the CIV Report, because the individual investor's identity is proprietary information belonging to the distributor, CIVs often do not know the identity of the underlying owners of the CIV units.[4] Nevertheless, as noted above, they often have very strong indications of the underlying owners' tax residency because of the identity of the distributor through which the investment was made.

A CIV's investor base typically changes every day. In some cases, investor turnover can be high. In the case of a globally-distributed CIV, where the CIV units are more likely to be held both by treaty-

[2] http://www.oecd.org/dataoecd/23/43/45689328.pdf

[3] Paragraph 15 of the CIV Report explains the reasons why, in many cases, "essentially all of [a domestic CIV's] investors are located in the same country."

[4] *See* Paragraph 18 of the CIV Report.

entitled persons and non-treaty-entitled persons, the portion of treaty-entitled investors is likely to change relatively slowly.[5]

A CIV does know precisely how many CIV units are outstanding on each day. Among other reasons, this information is necessary for a CIV to compute its daily "net asset value" (or "NAV") – which is the price at which a single unit of the CIV will be purchased or sold. The NAV is calculated by determining the CIV's gross assets, subtracting gross liabilities, and dividing by the number of shares outstanding. Because withholding taxes and treaty relief affect NAV, CIVs have a keen interest in certainty regarding their eligibility for treaty relief.

A CIV investor typically has an undivided interest in the CIV's assets. Because of the daily changes in a CIV's investor base, however, income streams (such as a dividend received on 15 June) are not tracked to particular investors (such as those owning interests in the CIV on 15 June). Instead, when a CIV makes a distribution, the distribution is allocated pro rata to all of the investors in the CIV (based on the number of units owned as of the date of the distribution).[6]

Difficulties Faced by CIVs in Claiming Treaty Relief

The CIV Report describes in detail the difficulties faced by CIVs claiming treaty relief. The difficulties are of two kinds. First, difficulties arise if a CIV is required to determine the tax residency of its investors too frequently or with too much precision. The reasons for these difficulties involve the daily changes in a CIV's investor base and the intermediated structure through which CIV interests are distributed.

Second, difficulties arise because of uncertainty regarding the extent to which certain CIVs may claim treaty benefits in their own right and when they must claim on behalf of their investors. The CIV Report discusses at length the specific requirements that a CIV must meet to claim treaty relief in its own right. These requirements – that the CIV be a person, that it be a resident of a contracting state, and that it be the beneficial owner of its income – are met by many CIVs.[7] If a CIV does not satisfy these requirements, the only practical manner in which the CIV's investors may receive treaty benefits is if the CIV makes a claim on their behalf.

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[5] *See* Paragraph 6.31 of the Commentary.

[6] *See* Paragraph 20 of the CIV Report.

[7] *See* Paragraph 36 of the CIV Report.

CIV-Specific Changes to the Model Convention Commentary

To address these difficulties, the CIV Report proposes several changes, since adopted, to the Model Convention Commentary. Among other things, the Commentary suggests mutual agreements between countries regarding the treatment of a country's CIVs. The Commentary also notes the difficulties in identifying investors on a frequent basis and suggests that "practical and reliable approaches" be accepted.[8] Where a CIV industry is largely domestic, such as because tax rules provide strong disincentives for non-resident investment, the Commentary states that it may be appropriate to assume that the CIV is owned by the residents of the country in which it is established.[9] Where a CIV is distributed globally, the Commentary suggests that investor information be required annually; if market conditions suggest high ownership turnover, this information could be required more frequently – although no more often than quarterly.[10]

The Present Situation in Korea is Extremely Problematic and Should Be Resolved Promptly

Certainty and Administrable Rules are Essential

Certainty regarding treaty eligibility and administrable rules for claiming relief, as discussed in the CIV Report, are of paramount importance to CIVs. Without this certainty, as noted above, a CIV may mis-price its units – resulting in purchasers and sellers paying or receiving too much or too little for their units.

The present situation with Korean tax relief, at best, is uncertain. At worst, CIVs that may claim treaty benefits in their own right, and treaty-eligible investors in CIVs that must claim on behalf of their investors, effectively are being denied their bilaterally-negotiated treaty benefits.

We encourage the Korean Ministry of Strategy and Finance ("MOSF") and National Tax Service ("NTS") to adopt the recommendations we make below. These recommendations are consistent with the OECD guidance that was developed with the participation of the Korean representatives to the OECD.

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[8] *See* Paragraph 6.29 of the Commentary.

[9] *See* Paragraph 6.30 of the Commentary.

[10] *See* Paragraph 6.31 of the Commentary.

The Presidential Decree and Form No. 29-13

The Presidential Decree regarding Article 98-6 of the Korean Income Tax Law ("CITL")[11] appeared to provide the administrable rules that CIVs need. Specifically, Paragraph 3 of Article 138-7 of the Presidential Decree provides that an offshore investment vehicle ("OIV") that (1) satisfies the requirements for qualifying offshore collective investment vehicle ("OCIV") status, (2) submits a "Confirmation report of OIV," and (3) meets certain conditions, would not be required to file beneficial owner details.

Despite the Presidential Decree's helpful guidance, and contrary to the OECD's Model Convention Commentary, we understand that no CIV may claim treaty benefits in its own right by filing Form No. 72-2 (Application for Entitlement to Reduced Tax Rate on Domestic Sourced Income (for Foreign Corporation)). Moreover, the form that all CIVs reportedly must use – Form No. 29-13 (Report of Overseas Investment Vehicles) – requires quarterly reporting of exhaustive information about a CIV's investors, sparing a CIV with 100 or more investors only from having to directly name its investors. This quarterly reporting is inconsistent with the OECD recommendation that quarterly reporting be required only when investor turnover is high. Additionally, even if a fund has access to the detailed information required by Form No. 29-13, the requirement to provide reporting based on the end of the preceding quarter does not give such fund adequate time to compile data and prepare the Form.

Proliferating Uncertainty

Compounding the uncertainty surrounding claims for treaty benefits in Korea, our members now report that Korean brokers expect that CIVs selling shares of Korean companies to other non-residents file the overseas investment vehicle report on capital gain transactions. These forms are being requested based upon a misunderstanding of Korean law – under which these transactions are exempt from tax.

In the absence of coherent guidance clarifying the law, forms are being requested when they are not needed and properly-filed forms (when required) are being rejected. The Korean market, we believe, is trending dangerously toward unnecessary and unadministrable tax reporting. The proliferating uncertainty is causing some investors to forego their treaty-entitled benefits; foreign investment in Korea may be affected negatively.

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[11] This Decree was issued by MOSF Public Notice No. 2012-3 (January 6, 2012).

Lack of Reclaim Procedure

Further aggravating the situation, we understand that no market level procedure exists for CIVs, that are withheld upon at the statutory rates, to certify their treaty eligibility and subsequently apply for a reclaim or refund of the withheld taxes. The local custodians, in their capacity as withholding agents, are not authorized to file tax reclaims on behalf of non-resident investors. Pursuant to an existing procedure only the beneficial owners are able to file requisite Form Appendix VI 72-3 (Tax Refund Application by Foreign Corporation) or Form 29-14 (Tax Refund Application by Nonresident Individual) directly with the NTS. The lack of Tax Refund form designated for CIVs leaves them with the only recourse of filing a suit against the NTS for the overwithheld amounts. Both beneficial owners and CIVs are also required to engage Korean tax counsel in order to pursue the tax reclaim filing, thereby further increasing the cost and administrative burden of availing of treaty relief.

If no refund procedure is available, the present situation is contrary to accepted international tax norms and exacerbates greatly the problems posed by the Presidential Decree and Form No. 29-13. Combined, these issues result in the effective denial of treaty benefits Korea owes to residents of a Contracting State.

Recommendations

1. All CIVs treated as both Persons and Residents by the country in which they are organized (*e.g.*, all CIVs treated as corporations for tax purposes and other non-fiscally-transparent CIVs) should file Form No. 72-2 to claim treaty benefits in their own right.

2. Any CIV that cannot claim treaty benefits in its own right (under our first recommendation above) should file Form No. 29-13 on an annual, rather than quarterly, basis. Additionally, to allow adequate time for gathering data and preparing the Form, such annual reporting should be due no sooner than one calendar quarter from the close of the year.

3. For purposes of the 100-investor rule for filing as a public CIV, another OIV investing in a CIV should not be treated as a single investor. Rather, the OIV should provide details regarding the number of its investors; the CIV should be permitted to rely upon these representations and any other information available to it, Under this proposal, the 100-investor rule would require detailed reporting only if there are fewer than 100 actual investors throughout the intermediated distribution structure.[12]

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[12] These issues were addressed in detail in a letter submitted by the Investment Company Institute and ICI Global (attached) on 20 January 2012. In the context of an OIV that offers its shares to insurance companies that in turn make the OIV available to individual investors through variable insurance products, for example, the OIV should be permitted to satisfy the 100-person requirement based upon the number of investors in the variable insurance products offered by the insurance companies that are invested in that OIV.

4. Guidance should be provided that the tax exemption for capital gain transactions between non-residents applies regardless of whether any of the non-residents is a CIV. Such guidance is needed promptly to reassure brokers that their foreign investors can trade their positions without incurring tax or reporting obligations.

5. A "quick refund" procedure should be reestablished. This procedure would allow treaty-entitled investors a grace period to provide documentation and would reduce unnecessary administrative burdens that would be placed on investors, custodians, and the Korean tax authorities by a lengthy reclaim process.

6. A tax reclaim process should be established for treaty-entitled investors that cannot provide required tax documentation before the income event (or the end of the grace period provided by our fifth recommendation).

Conclusion

Investor confidence in receiving tax treaty benefits that were understood to be available in Korea is eroding across the global funds industry. We believe that Korea's present tax treaty administration issues must be addressed by positive guidance in short order to remedy the investor concerns regarding the tax treatment of their Korean capital markets investments.

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Please feel free to contact the representatives at the associations signing this letter, at your convenience, for additional information.

Sincerely,

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By Electronic Delivery

January 20, 2012

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Korea

RE: Treaty Relief for Offshore Investment Vehicles Under Article 98-6 of the Corporate Income Tax Law and Draft Presidential Decree Article 138-7

Dear Sir:

The Investment Company Institute ("ICI")[1] and ICI Global[2] support administrable rules that allow publicly offered, regulated collective investment vehicles ("CIVs") to receive the applicable withholding tax relief provided by Korea's double tax treaties. Because these CIVs generally have several thousand (or more) investors who may buy and sell CIV interests on a daily basis, it is essential that the CIVs be able to make all appropriate treaty benefit claims.

We are pleased that the draft Presidential Decree regarding Article 98-6 of the Korean Income Tax Law ("CITL")[3] provides rules for qualifying offshore collective investment vehicles ("OCIVs") that appear designed to address our concerns.[4] In this letter, we request clarification regarding how the

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.47 trillion and serve over 90 million shareholders.

[2] ICI Global is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICIG seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICIG manage total assets in excess of US $1 trillion.

[3] This Decree was issued by MOSF Public Notice No. 2012-3 (January 6, 2012).

[4] Our comments are based upon an unofficial English-language translation of the draft Presidential Decree. We might have additional comments if the unofficial translation is inaccurate.

OCIV rules apply in certain contexts and raise some concerns with the timing for additional guidance (such as the forms that must be filed).

Paragraph 3 of Article 138-7 of the draft Presidential Decree provides that an offshore investment vehicle ("OIV") that satisfies the requirements of an OCIV, that submits a "Confirmation report of OIV," and that meets certain conditions will not be required to file beneficial owner details. The three conditions described in this paragraph are that the OIV (1) is "regulated by the financial supervisory authorities of the contracting state"; (2) had an average number of investors during the preceding fiscal year of at least 100; and (3) is not on a list of excluded OIVs under the treaty. These conditions appear to largely follow the changes to the Commentary to the Organization for Economic Cooperation and Development's ("OECD's") Model Treaty that were adopted by the OECD's Committee on Fiscal Affairs in 2010.

The 100-investor requirement potentially could be problematic in two situations. First, a newly-created OIV might not have 100 investors for a relatively short period after it is formed. If the OIV also has a very short fiscal year (for example, the OIV is organized in November and has a fiscal year ending on December 31), the OIV might have fewer than 100 investors, on average, each day of its fiscal year.[5] As the requirement for treaty benefits is that the OIV meet the 100-person requirement for the preceding year, a start-up fund might lose benefits for the year after it is formed (when it may have no fewer than several thousand investors each day) simply because it did not attract a large investor base immediately upon its formation. To address this concern, we request clarification that an OIV will be treated as meeting the 100-person requirement if it both (1) has at least 100 investors on the last day of its first fiscal year and the first day of the second fiscal year[6] and (2) certifies that it anticipates meeting the 100-person requirement for this second fiscal year.

A second aspect of the 100-investor requirement that could be problematic relates to what we understand to be a requirement that treats an OIV investing in another OIV as a single investor. This condition, if applied broadly, could be problematic in three situations.

First, many shareholders in OIVs acquire their interests through intermediaries that then hold the OIV shares for their customers in nominee accounts. An intermediary easily could hold shares for

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[5] For example, the OIV might have only one investor (the fund manager) for the first 10 business days of its operation, 50 investors for the next 10 business days, and 125 investors for the final 10 business days. In this example, the average number of investors for the previous fiscal year would not be at least 100 – although the 100-investor threshold would have been met by the end of the fiscal year and the fund could anticipate meeting the threshold during the next fiscal year.

[6] Alternatives could be advanced, such as taking the average for a specified period around the end of the fiscal year (*e.g.,* the average of investors for the last five days of the first fiscal year and the first five days of the second fiscal year). If an alternative is considered, the length of the period during the second fiscal year should be short, as OIVs will need to instruct their custodians before the first payment subject to relief that the 100-person requirement has been satisfied. Our proposal to require the OIV to certify that it anticipates meeting the 100-person requirement for the second fiscal year is intended to address the same concern about basing a determination only on the shareholder base for the last day of the fiscal year.

thousands of individual investors. Since the Presidential Decree uses the term "investors," and the individuals holding through the intermediary are the ones whose money is being invested in the OIV, we assume that the 100-person limit is determined by treating these individuals as the "investors." To address any ambiguity, we request that an OIV that offers its shares through intermediaries be permitted to satisfy the 100-person requirement based upon the number of investors holding shares in the OIV through intermediaries (which should not be treated as OIVs under the Presidential Decree).

A related issue involves individuals who invest in an OIV through a regulated insurance product such as a variable annuity or a variable life insurance contract. In this situation, as in the first, the individuals acquiring the variable insurance product are the ones whose money is "invested" in the OIV. As in the first situation, we assume that the 100-person limit is determined by treating these individuals as the "investors." To address any ambiguity, we request that an OIV that offers its shares to insurance companies, that in turn make the OIV available to individual investors through variable insurance products, be permitted to satisfy the 100-person requirement based upon the number of investors in the variable insurance products offered by the insurance companies that are invested in that OIV.

A final issue involves so-called master-feeder funds where the investing (portfolio) OIV may be held only by other OIVs that offer their shares to the general public. This structure can allow different small financial firms to invest in the same portfolio but offer their "own" fund to their clients. If each "secondary OIV" were treated as a single investor, the "master" (portfolio) fund would not meet the 100-person requirement even though it would be held, effectively, by many thousands of investors. To address this concern, we request clarification for a master-feeder fund structure that is created under the laws of a foreign country which are similar to the master-feeder fund structure provided for by Article 233 of the Financial Investment Services and Capital Markets Act (Law No. 8635 (2007) as amended. Specifically, we request that a "master" (portfolio) OIV in a master-feeder fund be permitted to satisfy the 100-person requirement based upon the number of shareholders in the secondary OIV feeder funds investing in the master fund.[7]

We understand that the relevant forms (such as the "OIV Confirmation Report" and the "Application of Reduced Withholding Tax Rates") have not been issued. OIVs and their custodians would like to study each such form when released in due course in order to provide comments such as suggested fill-in instructions and to request clarification regarding a form's requirements in specific factual situations. We urge the Ministry to release these forms, perhaps only in draft form, to allow sufficient time to comment and ensure compliance by the July 1, 2012 effective date for the new requirements.

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[7] A similar issue might arise for the "fund of funds" structure where one fund invests only in other funds with differing investment objectives. In this case, the first ("top tier") effectively allocates its investors' money into "lower tier" funds to gain asset diversification that can be adjusted to reflect changing market conditions. The investors in the upper-tier fund should be taken into account in determining whether the lower-tier fund meets the 100-person requirement. Clarification of this point also would be appreciated.

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We appreciate your consideration of our requests. A Korean-language translation of this letter will be provided soon. Please feel free to contact me (at lawson@ici.org or 001-202-326-5832) or my colleague Pinank Desai (at pinank.desai@ici.org or 001-202-326-5876) if ICI or ICI Global can provide you with any additional information.

Sincerely,

/s/ Keith Lawson

Keith Lawson
Senior Counsel – Tax Law