



## Korea Tax Newsletter

### November 2015

#### Revisions to the laws

##### Local Tax Law

On October 1, 2015, the Ministry of the Interior announced proposed revisions to the Local Tax Law, Local Tax Basic Law and Local Tax Incentive and Limitation Law and thereafter the proposed revisions to its Presidential Decree and Enforcement Regulation were announced, respectively on November 9 and 11. The proposed revisions would generally become effective from January 1, 2016 unless specified otherwise.

##### **Change in de minimis threshold for resident tax on employee**

Before the revision, if the number of employees does not exceed 50, a Korean business is not obliged to pay resident tax on employee, which is imposed at 0.5% of monthly employee payroll. According to the proposed revision, a basis of de minimis threshold is changed from the number of employees to monthly average payroll amount. Specifically, if the monthly average payroll amount of the recent one year of the Korean business does not exceed 50 times of KRW 2.7 million (i.e. KRW 135 million), the Korean business would be exempt from

resident tax on employee.

### **Deemed acquisition tax for a majority shareholder**

In case where a majority shareholder (who has acquired more than 50% of shares in a company) acquires additional shares, it is subject to a Deemed Acquisition Tax ("DAT") at 2.2% (2% for vehicles) on the book value of the company's certain taxable assets multiplied by the increased ownership ratio of the majority shareholder. However, if the ownership ratio after the additional share acquisition is not more than the maximum ownership ratio within immediately preceding 5 years, it would not be subject to a DAT. Under the proposed revision, the limit on period is abolished and therefore, if the ownership ratio after the share acquisition is lower than the previous maximum ownership ratio, the additional acquisition of shares by a majority shareholder would not be subject to a DAT.

### **Statute of limitation of local tax**

The statute of limitation period under the Local Tax Basic Law is extended from 5 or 7 years to 10 years in case where tax returns are not filed until the due date in the event of acquisition through a gift, or when an actual owner acquires real estate in substance under the nominal trust agreement in accordance with the 'Law on the Registration of Real Estate under Actual Titleholder's Name'. The proposed revisions will be effective from the day on which local tax can be levied after the enforcement date of the law.

### **Alleviation of penalty on failure of withholding tax obligation**

In case where it fails to fulfill proper withholding obligation, a withholding agent would be subject to penalty which is the sum of 10.95% per annum of interest penalty and 3%(previously 5%) of un/underpaid withholding tax capped at 10%. The proposed revisions will be applicable to local tax which tax liability accrues after the enforcement date of the law.

### **Improvement of taxpayer's rights**

Before the proposed revision, even for a taxpayer who does not have any local tax payable, un/under reporting penalty is imposed if the taxpayer does not properly comply with the reporting obligation. However, un/under reporting penalty will be imposed based on actual tax payable amount under the proposed revisions. If there is no local tax payable, a taxpayer would not be subject to tax penalty from failure of the reporting obligation. Also, in case where a taxpayer does not pay additional taxes when filing amended tax returns or overdue tax returns, un/under reporting penalty would not be imposed. The proposed revisions will be applicable to the local tax which tax liability accrues after the enforcement date of the law.

### **Enhancement of convenience for taxpayer**

Before the proposed revision, the local income surtax return should be filed with each district office to which each place of business belongs, together with other supporting documents (e.g., financial statements, allocation statement of local income surtax, etc.). However, according to the proposed revision, a taxpayer can submit other supporting documents only to the relevant district office of the business headquarters' location.

## **Foreign Investment Promotion Law**

On October 16, the Ministry of Trade, Industry and Energy announced proposed revisions to the Presidential Decree of Foreign Investment Promotion Law.

### **Foreign investment amount**

In order to qualify as a foreign investment under the Foreign Investment Promotion Law, the investment amount should be more than KRW 100 million. Under the proposed revision, even in case of capital redemption with no consideration, it becomes clear that the existing investment amount would remain unchanged.

## **Commercial Code**

The Korean National Assembly passed the revisions to the Commercial Code on November 12 which newly adopts various M&A measures to facilitate companies' restructuring and investment through expanding M&A market and promoting economic growth. The major revisions are as below and, unless specified otherwise, the revisions become effective from 3 months after the law is promulgated.

### **Adoption of triangular share exchange, reverse triangular merger and triangular split-off merger**

In order to meet economic demands for various M&A structures using a subsidiary, the rules for triangular share exchange, reverse triangular merger and triangular split-off merger are newly introduced in addition to the existing triangular merger.

(\*) Definition of terms

- Triangular share exchange: In case of a share exchange transaction, the parent company's shares are issued to shareholders of a target company and shares of a target company are issued to the subsidiary. In the end, the target company becomes a grandson company of the parent company.
- Triangular merger: In consideration for a merger, a subsidiary provides a parent company's shares to shareholders of a target company and the target company is merged into the subsidiary.
- Reverse triangular merger: In consideration for a merger, a subsidiary provides a parent company's shares to shareholders of a target company and the subsidiary is merged into the target company.

### **Opposing shareholders' rights to request to the company for the purchase of shares**

As it has not been clear on whether shareholders of non-voting shares can exercise rights to request to the company for the purchase of shares owned by the shareholders when they are opposed to a resolution of shareholder's meeting, the revision makes it clear that the shareholders of non-voting shares can exercise such rights. The revision would apply from the case when the request to the company for the purchase of shares is on-going at the time of enforcement date of the revised Commercial Code.

### **Alleviation of conditions for small-scale share exchange**

Like a small-scale merger, in case where the total number of shares newly issued for a share exchange does not exceed 10% (previously 5%) of outstanding shares of the company which becomes a wholly owning parent

company after the share exchange, the approval can be made by a board of directors' meeting instead of a general meeting of shareholders. Also, according to the revisions, in case where the total number of treasury shares transferred for a share exchange or merger does not exceed 10% of outstanding shares, it would also qualify as a small-scale share exchange or merger.

### **Adoption of a simplified transfer, takeover or lease of business**

Like a simplified merger or share exchange, in case where all shareholders of a company which involve a transfer, takeover or lease of business give their consent or in case where more than 90% of outstanding shares of the company are owned by the transaction party, the approval of a general meeting of shareholders of the company may substitute for the approval of the board of directors.

## **News from tax authorities**

### **Action Plans to BEPS Project**

As the BEPS (BEPS : Base Erosion and Profit Shifting) measures were agreed in the G20 Leaders' Summit held on November 15 and 16, the Ministry of Strategy and Finance ("MOSF") has announced its action plans to the BEPS Project in the below categories which aims to prevent tax evasion of Multinational Enterprises(MNEs).

BEPS Project(1): Minimum standards

BEPS Project (2): Ensuring coherence of corporate income taxation

BEPS Project (3): Preventing abuse of international standards

BEPS Project (4): Ensuring transparency

The main action plans for BEPS Project (1) and (2) are summarized as below and other action plans for BEPS Project (3) and (4) are targeted to be announced by early December.

<b>Project</b>	<b>Action</b>	<b>BEPS Issue</b>	<b>Action Plan of the MOSF</b>
<b>Minimum standards</b>	Prevent treaty abuse	Unjust benefit of non-taxation or reduced taxation through tax treaty abuse	<ul style="list-style-type: none"> <li>- Korea has adopted the Principal Purpose</li> <li>- Test (if a principal purpose of the transaction is to obtain treaty benefits, these benefits would be denied).</li> <li>- Korea has not previously adopted Limitation on Benefits rule (which limits the availability of treaty benefits to entities that meet certain conditions), but the rule will be reviewed in depth before adoption.</li> </ul>
	Counter harmful	Base erosion and profit	- No exception was noted for Korea as a

	tax practices	shifting to low tax rate countries which provides preferential tax regimes for income to shift easily (e.g. service or intellectual property)	<p>result of OECD Harmful Tax Practice Test.</p> <ul style="list-style-type: none"> <li>- The foreign investment promotion laws will be reviewed from the perspective of harmful tax practices and an adoption of new harmful tax practice will be restricted.</li> </ul>
	Country-by-Country Report	Insufficient information for tax authority on MNEs' transfer pricing ("TP") report	<ul style="list-style-type: none"> <li>- The submission of country-by-country report is under the review for its legislation in 2016.</li> <li>- With the adoption of submission requirement for new TP documents, profit distribution, economic activities, tax filing status of MNEs and etc. will be shared among countries.</li> </ul>
	Dispute resolution	Increase in uncertainty and disputes in the interpretation and application of numerous new tax treaties	<ul style="list-style-type: none"> <li>- Whereas current Korean tax laws and practice correspond to the minimum standards, but certain regulations need to be revised to reflect the recommendations.</li> <li>- Implementation of mandatory binding arbitration (a third party will be involved upon taxpayer's request for unresolved disputes within 2 years after initiation of international coordination) will be carefully reviewed.</li> </ul>
<b>Ensuring coherence of corporate income taxation</b>	Hybrid mismatch arrangements	Double non-taxation by using differences in the tax treatment of an entity or instrument (e.g. convertible bond) under the laws of two or more tax jurisdictions	<ul style="list-style-type: none"> <li>- In order to reflect the recommendations, a revision in the domestic law and treaty will be reviewed</li> </ul>
	Strengthen CFC rules	Profit shifting and deferral of taxation on the income of a foreign subsidiary in CFC jurisdictions	<ul style="list-style-type: none"> <li>- CFC rule has been implemented since 1995 and the OECD recommendation has already applied.</li> <li>- Some rules which are different from recommendations (Note 1) will be reviewed for the revision taking economic effect into consideration.</li> </ul>
	Limitation of	Base erosion through	<ul style="list-style-type: none"> <li>- Korea has thin capitalization rules to limit</li> </ul>

deductions for interest expenses	the use of interest expense from highly leveraged financing structure	deductions for interest expense (Note2). - Fixed ratio rule (which limits an entity's net deduction for interest expense to a percent age of its earnings before interest, taxes, d epreciation (EBITDA)) has not been adopted but will be reviewed in 2016.
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(Note 1)

	OECD Recommendations	Domestic CFC rules
<b>Scope of CFC (entity)</b>	Corporation, Partnership, PE and etc.	Corporation
<b>CFC Income</b>	Suggested alternatives (either full taxation or partial taxation can apply) ① Passive income such as dividend and interest ② Income from non-substantial business activities ③ Income in excess of a normal return	① Full taxation on income from non-substantial business or passive income ② Even if ① is not applied, partial taxation on passive income, if the passive income exceeds 5% of gross income.
<b>Computation of Income</b>	CFC losses should only be offset against profits of CFC	No rules for the limitation of offsetting losses

(Note 2) If a domestic company borrows a loan from its Foreign Controlling Shareholder ("FCS") or a third party with a guarantee from the FCS, and such borrowing exceeds 200% (600% for financial company) of its equity (or contributed capital if greater than the equity) in the company, the interest expense on the borrowing exceeding the thin capitalization ratio of the FCS's equity in the company is not deductible.

✉ If you have any questions concerning the items in this month's newsletter, please contact your tax advisor at Deloitte Anjin LLC or the following tax professionals:

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