KOREA

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INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

Korea has long been endeavoring to adopt tax policies in line with global trends and OECD guidelines, which also include BEPS, and numerous tax-related amendments were made reflecting such efforts. While there are no particular changes in the past few months, the following should be taken into consideration in M&A deals.

In cases of share deals, in principle, a transferor must pay a capital gains tax on capital gains, but a transferee is not required to pay any special tax. However, if a transferee becomes an oligopolistic shareholder of the target company with assets subject to acquisition tax (e.g. real property) through transfer of existing shares, sometimes a transferee may be required to pay acquisition tax, etc.

In cases of asset deals, while a transferor must pay VAT on asset transfer gains in individual asset transfer cases, no VAT is required in comprehensive asset transfer cases. However, a transferee must pay acquisition tax, etc. The National Tax Service in Korea is currently reviewing the appropriateness of transfer pricing in cases of related party M&A transactions in depth.

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

In an effort to reflect the BEPS Action plan, the Korean Government has amended the relevant tax regulations including the Adjustment of International Taxes Act, (AITA), which is in line with OECD guidelines.

The relevant existing statutes provide the following provisions for taxation:

- Imposing taxes upon the actual beneficiary, not a nominal holder
- Imposing taxes associated with transfer pricing based on the arm's length price
- Interests paid to a foreign controlling shareholder will be deemed as a dividend and the relevant tax will be imposed accordingly (thin capitalisation rule)
- In cases where a local resident invests in a foreign corporation having its headquarter in a country which taxes 15% or less of the actual income generated, the amount from a distributable reserve income of such foreign corporation at the end of each fiscal year belonging to the local resident will be deemed as a dividend paid to the local resident and will be taxed accordingly
- Exchanging tax and financial information between nations

In particular, pursuant to the amendments to the AITA, a taxpayer engaged in an international transaction with a foreign related party must file both an international transaction schedule and an international transaction integrated report with the competent tax authorities. Also, the BEPS Action Plan will be reflected continually in the relevant rules and regulations in the future.

CbCR has been added to the International Consolidated Report submission requirement enacted around December 2015 (previously, the AITA only required a consolidated corporate report and individual corporate report).

The AITA states that the specific scope, method, procedure etc. of the CbCR submission will be prescribed by presidential decree (Article 11.4) and the relevant Enforcement Decree (Article 21-2) was amended on 7 February 2017.

According to the Enforcement Decree, in principle, a domestic corporation which is the ultimate parent entity of a multinational enterprise group (MNE group) with sales exceeding KRW 100 billion according to its consolidated financial statements for the immediately preceding tax year must submit a CbCR. In the case of a MNE group with certain controlling shareholders located overseas, if the laws of the country where such controlling shareholders are located do not require CbCR submission or if there is no tax treaty between Korea and such country etc. whereby the CbCR can be exchanged, then the domestic subsidiary/branch of the MNE group must submit a CbCR.

The CbCR must include country-by-country taxpayer and related corporation revenue details, country-by-country before-tax profits and losses, country-by-country tax paid and capital, etc. The domestic parent company and domestic subsidiary/branch of a MNE group must submit material related to the person obligated to submit the CbCR within six months from the end of the business year to the tax office with jurisdiction over the place of tax payment.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

In the case of a share deal where there is a transfer of shares, while a transferor must pay a capital gains tax on capital gains from a share transfer, a transferee is not required to pay any special tax.

An asset deal is classified into two categories: an individual asset transfer and a comprehensive asset transfer. A transferor must pay a capital gains tax and VAT on asset transfer gains in individual asset transfer cases, whereas no VAT is required in comprehensive asset transfer cases. In the case of an asset deal, a transferee must pay acquisition tax, registration tax, etc.

A. Share deal

Tax advantages:

As the target company continues to exist and the only change is a change in its shareholder structure, tax payment records of the target company may remain the same. Furthermore, other than a small sum of tax such as a securities transaction tax, a transferee is not required to pay any special tax.

Tax disadvantages:

The target company's tax records may remain the same and a transferee must bear all unrecorded liabilities, contingent liabilities, etc. of the target company.

B. Asset deal

Tax advantages:

As a transferee only takes over assets of the target company, it may block out tax records, unrecorded liabilities and contingent liabilities of the target company.

Tax disadvantages:

In addition to a capital gains tax on asset transfer gains, there may be additional taxes such as VAT, acquisition tax, etc. as well.

BUY-SIDE

4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?

A stock acquisition does not change the fiscal identity of the target company. Hence, the value of the tangible and intangible assets of the target company remains the same. As such, the company's assets and liabilities will not acquire a different tax status. The target company will continue to depreciate or evaluate its assets as it did before the acquisition. However, a transferee, a new shareholder, may undertake a reevaluation of the value of the tangible and intangible assets through legal procedures.

5. WHAT ARE THE PARTICULAR RULES OF AMORTISATION OF GOODWILL INYOUR COUNTRY?

The term goodwill refers to the recognised right having an economic value due to the target company's capacity to secure excess earnings, in comparison with other enterprises in the same industry, by having an exclusive profit opportunity such as a favorable business relationship. Generally, such goodwill is evaluated by yield capitalisation approach, sales comparison approach and cost approach, and, in principle, such goodwill calculated by the said approaches is not amortised but only damages thereof are evaluated annually. In special cases such as the case of an acquisition through spin-off and merger, it may be deducted for tax purposes via amortisation within a period of five years.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

In share and asset acquisition cases, the thin capitalisation rule is applicable to any borrowing from a foreign controlling shareholder by a domestic corporation. The scope of foreign controlling shareholder of a domestic corporation will be any which falls under any of the followings as of the end of each business year:

- A foreign shareholder who directly or indirectly owns 50% or more of voting shares of a domestic corporation
- A foreign corporation, 50% or more of whose voting shares are directly or indirectly owned by a foreign shareholder described above.

The debt/equity ratio of 6:1 applies in the case of a foreign parent (or head office) in financial industry and the debt/equity ratio of 2:1 applies in all other cases

If the Korean subsidiary's borrowing from a foreign controlling shareholder exceeds the thin cap rule limitation, the interest expenses for the excessive portion paid to foreign controlling shareholder will be disallowed as an interest expense deduction, and treated as dividend distribution to foreign controlling shareholder (subjecting it to dividend withholding tax). The disallowed interest expense will increase the Korean subsidiary's corporate income and the corresponding corporate income tax.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE DEBT ON ACQUISITIONS?

There are numerous strategies to push down debt in acquisitions in Korea and one of them is a merger between an acquisition vehicle and the target company. In this method, the target company takes up loans borrowed by the acquisition vehicle upon completion of the merger. Besides such merging tactic, an acquisition vehicle finances based on the target company's assets and such collateral-based debt is repaid subsequent to the acquisition in some other M&A transactions. It would be important to note that, as the directors of the target company who approved the said merger may be held liable in certain cases, a careful legal review should be done prior to implementation such strategy in order to avoid a breach of fiduciary duty (there are many recent court cases where directors of targets were found to be liable both criminally and civilly for breaching their fiduciary duties).

Due to the thin capitalisation rule limitation discussed under question 6 above, in the case where a foreign controlling shareholder wishes to merge and acquire a domestic company, the debt/equity ratio would need to be structured at the optimal level. More specifically, it would be important to avoid high levels of debt when structuring the deb/equity ratio. Diversification of the composition of investors by attracting third-party investors, domestic investors and financial investors and strategic investors that are not foreign controlling shareholders may be one of the ways to achieve this purpose.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

The following shows some tax incentives for equity financing:

- An investment tax credit may be available to certain industries such as R&D industry
- Taxes such as a corporate tax may be reduced or exempted in certain foreign investment zones
- In the case of equity financing, a limit placed on expenses for tax purposes may be increased (e.g. entertainment expenses)

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

A loss carryforward of the target company may be deducted continually in calculating a corporate tax. Specifically, in the case of a share deal, a change of control of the target company does not affect the use of a loss carryforward.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

It would be necessary to review statements of tax adjustments, status of tax payments, etc. for the past three or five years. Furthermore, it would also be necessary to find out whether there was any tax investigation conducted by the National Tax Service and if so, the details and outcome thereof would need to be reviewed and analysed as well.

For instance, as corporate accounting based on K-GAAP and K-IFRS and tax accounting apply different standards, reviewing statements of tax adjustments will enable the verification of such differences. With regard to reviewing the status of tax payments, as this shows a history of tax payments made by a company, the status will show whether the company is in compliance with its tax payment obligations.

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

In the case of a share deal, there may be indirect taxes such as stamp duty, securities transaction tax, etc. and in the case of an asset deal, there may be indirect taxes such as stamp duty, VAT, etc.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

In both asset and share deal cases, so long as acquisition costs incurred are within the normal range, they may be recognised as expenses and tax deductible.

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

In the case of an asset deal, especially an asset deal through an individual asset transfer, VAT will be imposed, and such paid VAT may be recovered in certain cases.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION BY FOREIGN COMPANIES?

The thin capitalisation rule and VAT would need to be taken into account. Together with such, it would be necessary to prepare in advance and review the matters associated with a payment method of future dividends which will be paid out after acquisition of a domestic company by a foreign company, payment date, dividend tax, etc.

15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

While a group may reorganise after an acquisition based on newly arising circumstances and tax considerations, a careful examination should be given taking into account benefits and costs thereof.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

In the case where a transferee becomes an oligopolistic shareholder by acquiring the existing shares issued by the target company (if the transferee holds the existing shares issued by the target company exceeding 50%), such transferee is deemed to have acquired assets subject to acquisition tax such as real property owned by the target company by the transferee's equity ratio at the time of such share acquisition, and thus is required to pay the applicable acquisition tax. In the event the target company fails to pay its corporate tax, VAT, etc., then such transferee who has become an oligopolistic shareholder will bear secondary tax liability to pay such applicable taxes.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

Under tax law, in principle, each company is a taxpayer liable for payment of the applicable taxes, and neither fiscal unity nor tax grouping is allowed in Korea.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

In the case of an asset deal, as an asset transfer gain will be calculated as corporate income of a transferring company, it will be subject to corporate tax. In the case of a share deal, a capital gains tax on share transfer gains must be paid. Moreover, there are differences in the calculation method of share transfer gains, withholding tax, tax rate, etc. depending upon whether the transferring company has a domestic permanent establishment.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES ARE REINVESTED?

There is no special benefit in respect to reinvestment other than the benefit for investment in general.

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

In principle, in cases of small and medium-sized enterprises, there are no special requirements or regulations in respect of a holding company. On the other hand, large-sized enterprises (e.g. a company with assets of KRW 500 billion) are specially regulated by the Monopoly Regulation and Fair Trade Act.]

21. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

A tax break relating to VAT, acquisition tax, etc. will be given to certain mergers/spin-offs recognised under the Commercial Act, tax laws, etc., and other matters such as amortisation of goodwill should be reviewed for tax purposes.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

In cases where incentives such as stock options are granted to management, at each stage, careful consideration in respect to accounts and taxes should be given in dealing with matters including granting, vesting, exercising, etc.

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