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Korean Tax Brief

Update on Current Issues and Trends

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1. The Ministry of Trade, Industry, and Energy pre-announces new legislation of Corporate Vitality Improvement ("One-shot") Law

The Ministry of Trade, Industry, and Energy announced new legislation of Enforcement Decree (draft) of "The Special Law on Corporate Vitality Improvement" from March 7. This ""one-shot" law has been passed in the National Assembly's plenary session on February 4. This new law provides various benefits, such as simplification of procedures, tax incentives, etc. for companies planning a restructuring, but will be applicable only to those industrial sectors deemed to be burdened with overcapacity. According to the Enforcement Decree announced on February 25, tax support schemes are newly established for companies that carry out a voluntary restructuring. First, the payment of the capital gains on stock transfer that occur at the time of share exchange between the companies can be extended till the disposal of share and securities transaction tax is also exempted (not applicable to transactions between related parties). Also, when disposing duplicate assets occur in the merger, gain on asset transfer can be taxed over three years after the three-year deferment, and when the parent company acquires or repays the debt of the subsidiary for restructuring of the subsidiary, such costs are deductible. When the draft passes opinion convergence, examination of the Ministry of Government Legislation, the Cabinet meeting in the end of March, the Government will finalize and promulgate this law in June. The Special Law on Corporate Vitality Improvement is expected to be enforced from August 13, 2016.

2. Lower acquisition tax rate is applicable to the trust real estate

According to Article 11(1)-4 of the old Local Tax Law (currently Law No. 12153, January 1, 2014), in case of a transfer of trust real estate under the Trust Law from a trustee to a beneficiary, the acquisition tax rate (3%) lower than the general acquisition tax rate (4%) for the acquisition of real estate is

applied. The tax authority explained that the reason for allowing the lower tax rate on the acquisition of trust real estate, unlike a typical acquisition by succession for value, is to consider the fairness of taxation since the trust is based on special fiduciary relationship between the one who sets up the trust and the trust beneficiary, like inheritance based on a blood relationship, and if "special fiduciary relationship" between the consignor and the beneficiary is not observed, such as an acquisition of real estate by utilizing the trust system, then the lower tax rate under the above provision will not be applicable (2011. 10. 20., The local tax administration-4922 and more).

The A company reported and paid the acquisition tax at 3% on the acquisition of real estate for the building construction by utilizing the "disposal trust". However, the relevant tax authority imposed the 4% acquisition tax insisting that there is no "special fiduciary relationship" between the consignor and the trustee. The first trial court cancelled all of the acquisition tax imposition on the A company and the tax authority withdrew the appeal. Based on this case, corporations that paid the acquisition tax at 4% on the acquisition of trust real estate stipulated under the old Local Tax Law before amended on January 1, 2014 from the trustee of the real estate will be able to receive a refund of the taxes paid if reclaim for a tax refund.

3. Corporate car insurance is launched in April

Corporate-owned car insurance will be available as the provision for deductions of expenses related to corporate-owned vehicles is established. Financial Supervisory Service announced that indemnity insurance companies plan to sell the employee-only car insurance from April 1. It is based on the Enforcement Decree of the Corporate Income Tax Law ("CITL") which has been amended in February. Once the car insurance is launched, if a taxpayer changes to a corporate car insurance in the middle of the insurance period after getting a general car insurance or cancels in the middle of the insurance period, the tax benefits for the whole fiscal year cannot be received. If a corporation plans to rent a car for a business purpose, it should make sure that the rental car trader has obtained the special contract insurance for the corporation's employees. Due to the interim measure of the amended Enforcement Decree, if joined the general car insurance, rather than the employee-only insurance, before April 1, tax benefits can still be obtained in the same manner of the employee-only insurance until expiration of the insurance.

4. Tax treatment of the jointly-built system

In the recent tax ruling, considering that in case of subsidiaries with an ERP system, the percentage of sales to management of the head office product for most subsidiaries is 100%, while the percentage of trading with the headquarters for some subsidiaries does not reach 100% (about 80%), it was determined that whether the business structure of such subsidiaries affect "whether the ERP system is considered a headquarters' business asset" and that if such ERP system is considered a headquarters' business asset, whether or not the headquarters should receive the consideration for the use of ERP systems from its subsidiaries.

In case the parent company and the subsidiary build a global ERP system for the integrated management of the management information and process, and if the parent company bears all the construction cost of the system under the agreement with the subsidiary, and acquire the legal ownership and recognize the system as an asset for accounting purposes, the parent company can depreciate such system as its business asset. However, if the parent company does not collect the consideration for use of the system from the subsidiary, the provision on rejection of unfair act and calculation is applied in accordance with Article 52 of the CITL.

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In case of the merger where a domestic corporation with "0" stock value per share evaluated by the Inheritance and Gift Tax Act as a merging corporation and the other domestic corporation as a merged corporation, if the consideration for merger is fully paid with shares of the merging corporation to the shareholders of the merged corporation, this will satisfy one of the conditions for the qualified merger, which is "the value of stocks, etc. of the merging corporation is more than 80/100 of the consideration received by the shareholder of the merged corporation from the merger." When the merger between wholly-owned subsidiaries of foreign corporations meets all the conditions for a qualified merger and there are no gains on transfer for the merged corporation, such merger will not be treated as a rejection of unfair act and calculation.

KPMG contacts

For more information about how KPMG Tax can help your business with tax matters, please contact one of the following professionals.

Head of Tax

Choi, Jeong Wook
T. 82(2)2112-0990
E. jeongwookchoi@kr.kpmg.com

Global Tax Services

Ihn, Byung Choon
T. 82(2)2112-0983
E. bihn@kr.kpmg.com

Domestic Tax Services

Lee, Kwan Bum
T. 82(2)2112-0917
E. kwanbumlee@kr.kpmg.com

Lee, Chan Gi
T. 82(2)2112-0913
E. changilee@kr.kpmg.com

Financial Tax Services

Cook, Chang Soo
T. 82(2)2112-0918
E. changsoocook@kr.kpmg.com

kpmg.com/kr

Accounting and Tax Outsourcing (ATO) & Global Mobility Services

Kim, Ui Sung
T. 82(2)2112-0922
E. ukim@kr.kpmg.com

Transfer Pricing

Kang, Gil Won
T. 82(2)2112-0907
E. gilwonkang@kr.kpmg.com

M&A Tax Services

Koo, Jung Mo
T. 82(2)2112-0937
E. jungmokoo@kr.kpmg.com

Lee, Sung Wook
T. 82(2)2112-0946
E. sungwooklee@kr.kpmg.com