KOREA

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1. Introduction

1.1 General Information on M&A in Korea

M&A opportunities in Korea have dramatically increased since the Asian Economic Crisis in the late 1990s. Cross-border acquisitions have been particularly brisk in various industries. Sales of distressed companies have represented a large proportion of M&A deals in Korea since the Asian Economic Crisis. In recent years, a growing number of companies are turning their attention to M&A opportunities in order to increase corporate revenues and/or to gain various synergistic benefits. M&A activities among listed companies are also expected to become more common as shareholders become more knowledgeable about the advantages of M&A activities and related tax and legal issues. Although the number of M&A deals in Korea is growing, the Korean government continues to provide tax and other benefits to actively promote M&A activities.

1.2 Common Forms of Business Entity

The following forms of business entity are available in Korea. However, *Chusik Hoesa* is by far the most common form of business entity although recently *Yuhan Hoesa* has been used by some U.S. companies as it may be used to benefit from "check-the-box" rules under the U.S. tax code.

- Chusik Hoesa

  Chusik Hoesa (CH) is the only Korean business organisation permitted to publicly issue shares or bonds and, therefore, is the most common form of business entity used in Korea.

- Yuhan Hoesa

  A *Yuhan Hoesa* (YH) is a closely held corporation which may not have more than 50 shareholders. A YH may not publicly issue debentures. In most other respects, the formation, structure and conduct of a YH are similar to those of a CH.

  For U.S. tax planning, one possible advantage of using a YH is that it may be possible to obtain "flow-through" tax treatment in the U.S. At present, a Korean YH is an eligible entity under the U.S. "check-the-box" regulations and as such it may make an election to be treated as a partnership or "disregarded entity" for U.S. tax purposes. By contrast, a Korean CH is on the list of "per-se" corporations under the U.S. "check-the-box" regulations, and thus is not eligible to make such an election.

- Hapmyong Hoesa (Partnership)

  A *Hapmyong Hoesa* is organised by two or more partners who bear unlimited liability for the obligations of the partnership. *Hapmyong Hoesa* itself is subject to corporate income tax.

- Hapja Hoesa (Limited Partnership)

  A *Hapja Hoesa* consists of one or more partners having unlimited liability and one or more partners having limited liability. *Hapja Hoesa* itself is subject to corporate income tax.

1.3 Foreign Ownership Restrictions

Foreign investors may invest in most industries without any ownership restrictions. However, for a few industries such as newspaper and magazine publishing, telecommunications and cable broadcastings, the Korean government encourages foreign investors to establish a joint venture company with Korean partners rather than a wholly-owned subsidiary by restricting the amount of foreign ownership to a certain designated percentage.

1.4 Corporate Tax

A corporation, formed under Korean laws is subject to Korean tax on its worldwide income. A Korean corporation is entitled to either a deduction or a tax credit for foreign taxes paid with respect to the foreign-sourced income.

A branch of a foreign corporation is subject to tax on its income generated in Korea.

The corporation tax rates are as follows:

Tax base	Corporation tax	Resident surtax*	Total
₩0 – ₩100 million	13%	1.3%	14.3%
Over ₩100 million	25%	2.5%	27.5%

* Resident surtax is a local tax which is levied at 10% of corporation tax.

Korea has specific tax provisions dealing with transfer pricing rules, anti-thin capitalisation and anti-tax haven.

1.5 Tax Losses Carry Forward/Carry Backward

In general, tax losses may be carried forward for five years without having to satisfy any tests. Carry back of tax losses is generally not allowed except for one year carry back of losses which is available to small and medium sized companies.

1.6 Tax Groupings

Tax groupings are not available.

1.7 Tax Incentives for Foreign Investment

Foreign invested corporations may be entitled to tax incentives if they are involved in attracting advanced technologies or industry supporting services, as defined under the Special Tax Treatment Control Law, or are located in a designated Foreign Investment Zone, or the investment is of one that is designated by the Presidential Decree as being essential to attract foreign investments. The incentives may include exemption from and/or reduction in income tax, acquisition tax, registration tax, property tax and aggregate land tax, exemption from customs duties, special excise tax and VAT on capital goods imported and withholding tax exemption on payment of dividends and royalties to a foreign supplier of technology.

2. Acquisitions: Buyer's Perspective

2.1 Stock or Assets Acquisition

An acquisition of ownership of a Korean company may be achieved through asset or stock acquisition.

Buyers often prefer an asset deal to a stock deal, primarily to minimise the business, legal and financial risks of acquiring a company with cross-guarantees, uncollectible receivables, contingent liabilities and a host of other unknowns. Furthermore, when assets are acquired rather than shares, the buyer may be able to step up the basis of the assets to fair market value and to amortise goodwill resulting from the transaction over a period of five to twenty years.

2.1.2 Stock Acquisition

Acquisition of shares in a Target Company may be achieved in the following forms:

- Purchase of Existing Shares from Existing Shareholders by Foreign Investors

  A foreign investor may purchase shares in a Target Company from existing shareholders. The consideration for the shares would be paid to the existing shareholder who would be subject to capital gains tax in Korea on the gains. If the share ownership of the foreign investor equals to or exceeds 51%, the foreign investor would be subject to acquisition tax as explained below.

  A foreign investor would not be eligible for tax incentives under this type of share acquisition where existing shares are acquired.

- Purchase of New Shares of the Target Company by Foreign Investors

  A foreign investor may increase its share ownership in the Target Company through purchase of newly issued shares of the Target Company. The acquisition tax may also apply in this case. This type of foreign investment may be eligible for tax incentives applicable to foreign investment.

- Purchase of Shares in a Target Company through a Holding Company

  A foreign investor may set up a holding company in Korea to purchase existing shares or new shares in a Target Company.

  However, the investment by a holding company in a Target Company will not be treated as foreign investment. As such, the Target Company may not be eligible for tax incentives available to foreign-invested corporations.

2.1.3 Asset Acquisition

An asset acquisition may take the form of a "business transfer" which means "a comprehensive transfer of all the rights and obligations of a transferor related to the business" as defined under the Presidential Decree of the Basic National Tax Law. Where a transferee acquires only a portion of the target business assets or liabilities, it is usually called an "asset transfer" which is not considered "a comprehensive business transfer". However, in many cases it may be difficult to clearly differentiate between an "asset transfer" and a "business transfer".

2.2 Taxation

2.2.1 Stock Acquisition

- Deemed Acquisition Tax

  When a purchaser acquires 51% or more interest, together with related parties, in a Target Company, the purchaser is deemed to have acquired the target's assets and is subject to acquisition tax as described above. Through careful planning, the concerned tax may be minimised.

- Withholding Tax

  A foreign acquirer's dividend income paid by a Target Company is subject to withholding tax at 27.5% (including surtax), or at a treaty reduced rate, if applicable.

- Secondary Tax Liability

  An acquirer would bear secondary tax liability of a Target Company as a majority shareholder (i.e. holder of 51% or more of the target's outstanding shares) for any taxes in arrears (to the extent such tax liability is fixed on or after the acquirer becomes the majority shareholder) as well as relevant penalties, interest, collection expenses, and any remaining tax liabilities after appropriation of the target's property to pay such taxes.

- Government Reporting Requirements

  An acquisition of Target Company's shares would qualify as a foreign direct investment (FDI) subject to reporting requirements under the Foreign Investment Promotion Act (FIPA).

2.2.2 Asset Acquisition

- Acquisition Tax

  The acquisition tax ranging from 2.2% to 11% (including surtax) on the acquisition price of assets such as real estate, vehicles, certain construction equipment, aircrafts, vessels, mining rights, golf memberships, health club memberships, etc. transferred would generally be imposed at the time of acquisition.

- Registration Tax

  Registration tax ranging from 1.2% to 6% (including surtax) on the value of assets such as real estate, vehicles, certain construction equipment and aircrafts would be imposed at the time of registration of a change in ownership.

- Capital Registration Tax

  If the acquirer uses a new company as an acquisition vehicle, the acquirer is required to pay a registration tax of 0.48% (or 1.44%, where the surviving company is located in a prescribed metropolitan area, the registration tax rate would be levied at three times the regular rate) of the nominal value of paid-in-capital upon establishment or incorporation of the new company.

- Exemption or Reduction of Registration Tax or Acquisition Tax

  Certain local governments may grant exemptions or reductions of registration tax and acquisition tax arising in the course of a comprehensive business transfer. If a transferee of a business is exempt from registration and acquisition taxes in accordance with the concerned local government's ordinance, only the Special Tax for Rural Development shall be paid at the rate of 20% of the amount of the exempted registration and acquisition taxes.

- Secondary Liability for Taxes in Arrears

  An acquirer of a complete business (comprehensive business transfer) bears secondary tax liability for national taxes, penalty taxes, interest on deferred payments and expenses for collection of such taxes as well as local taxes, in arrears, but only to the extent of the liability of the transferor of the business at the date of the business transfer and limited to the value of assets transferred. Therefore, the potential purchaser of a comprehensive business should confirm with the relevant tax authorities whether the transferor has any tax liabilities in arrears before proceeding with the business purchase.

  In the event that a transferee acquires only a portion of the target business assets or liabilities (asset transfer), then the transferee may not be subject to secondary tax liability.

- Preservation of Tax Losses and Tax Incentives

  Tax loss and tax rate incentives of a Target Company are not allowed to be transferred to the acquiring company.

2.2.3 Tax Treatment of Transaction Costs

For example, due diligence fee and legal service fee, if any, incurred by a foreign buyer before the incorporation of a Korean entity, may not be allowed as deduction since such expenses are not relevant to the business of the Korean entity but are related to the acquisition of new business by the foreign buyer.

3. Impact on Basis

3.1 Stock Acquisition

The acquisition price of stock forms the cash base of the acquirer's stock in a Target Company, and there is no election available to step up the tax basis of the underlying assets.

3.2 Asset Acquisition

If a comprehensive business is purchased at fair market value, the acquisition cost of the target business assets may be stepped up (or down, as the case may be) to fair market value. If the transferee pays consideration in excess of the fair market value of the net target business assets acquired, the excess will be regarded as goodwill. For tax purposes, goodwill may be amortised in accordance with the accounting amortisation which is over five years or longer (but not longer than 20 years) using the straight-line method.

4. Tax Issues in Connection with Financing of Acquisitions

4.1 Debt

Specific tax issues relating to the overall level of borrowings and interest charged on debt are as follows.

4.1.1 Withholding Tax

Interest payments to foreign lenders are subject to withholding tax at 27.5% (including surtax). This rate may be reduced to a lower rate by a double tax treaty with a country of which the foreign lender is a resident and the treaty provides for such a reduction. However, interest payments to foreign lenders may be exempt under local rules from withholding tax if certain conditions are met.

4.1.2 Deductibility of Interest/Thin Capitalisation

Interest expense incurred in relation to a trade or business is generally deductible, subject to debt-equity ratio limitation.

A Korean subsidiary, or a Korean branch of a foreign corporation, is subject to thin capitalisation rules (the "thin-cap rule"). Under the thin-cap rule, if loans from overseas controlling shareholders (OCS) or loans guaranteed by OCSs exceed three times (six times in the case of financial institutions) the equity held by OCSs, the interest on the excess amount of the loans is not deductible. For purposes of the thin-cap rules, an OCS may be defined as any of the following:

- a foreign shareholder owning directly or indirectly 50% or more of the Korean company's shares;
- any foreign company in which the parent company (foreign shareholder of a Korean company, as defined above) owns directly or indirectly 50% or more of the shares; or
- any related/unrelated foreign shareholder company which has substantial control or influence over the Korean company.

4.1.3 Key Non-Tax Issues

A loan with maturity of five or more years made by a foreign parent to a Korean subsidiary would qualify as foreign direct-investment subject to reporting requirements under FIPA.

4.2 Equity

The capital registration tax is imposed at a rate ranging from 0.48% to 1.44% (including surtax) on the amount of paid-in capital on the acquisition of new stock.

Dividends paid on stock are not tax deductible to the company paying the dividends.

Dividend income received by a Korean company constitutes taxable income of the company. However, a qualified holding company under the Free Trade Act (FTA) that owns 50% (30% in the case of a listed subsidiary) or more of the equity in its subsidiary will be allowed a deduction equivalent to 60% to 100% of the dividend received.

A company which is not a qualified holding company under the FTA will be allowed a deduction equivalent to 30% to 100% of the dividends received if certain conditions are met.

In order to prevent a holding company and any other company from expanding control over their subsidiaries through borrowings, dividend received deduction is reduced as borrowings and interest costs of the parent company is increased.

Dividend income paid by a Korean company to a non-resident is subject to withholding tax which is to be deducted by the Korean payer from the gross payment.

5. Disposals: Seller's Perpective

5.1 Stock Disposal

5.1.1 Capital Gains Tax

A domestic corporate shareholder, including a taxable permanent establishment or branch of a foreign person, will generally be subjected to 27.5% corporate income tax rate on gains derived from the sale of shares in a Korean entity. The capital gain is generally calculated as the difference between the acquisition cost of the shares and the sales proceeds received in the exchange. The securities transaction tax paid will be deducted from the sales proceeds of the shares for the purpose of calculating the capital gain.

Under Korean tax laws, non-resident shareholders' capital gains on the sale of shares in a Korean company are generally subject to income tax (by way of withholding) at the lesser of 11% of the gross proceeds received or 27.5% of the net capital gain.

However, gains derived from the sale of shares in a Korean company are not subject to Korean tax if a foreign transferor meets the following conditions:

- the foreign transferor does not have a permanent establishment (PE) in Korea;
- the shares being transferred are publicly listed; and
- the foreign transferor did not own 25% or more of the shares of the publicly listed entity during the last five years.

In addition, the above tax rates may be reduced or eliminated in accordance with the provisions of an applicable double tax treaty.

5.1.2 Securities Transaction Tax

A security transaction tax of up to 0.5% may apply (based on the fair market value of the unlisted shares transferred). This tax shall generally be paid by the seller and applies even where the transfer is a share exchange between foreign companies. In certain cases, a transferor may be exempt from or subject to a lower rate of the securities transaction tax. To the extent the fair market value of the shares is not readily ascertainable, the value may be assessed in accordance with the Inheritance and Gift Tax Law.

5.2 Asset Disposal

5.2.1 Corporate Income Tax on Capital Gains

Corporate income tax will generally apply to any taxable gains realised by the seller in a business transfer. The applicable tax rate will be the regular corporate income tax rate. It should be noted that there exists a risk of double taxation because dividend distributed to shareholders would also be subject to Korean taxation.

5.2.2 Value Added Tax (VAT)

Generally, the seller in a “comprehensive business transfer” is not required to charge the 10% VAT for the assets transferred to the buyer, because a “comprehensive business transfer” is generally not regarded as a supply of goods for VAT purposes.

However, in the event that a buyer acquires only a portion of the target business assets or liabilities, the transfer may be subjected to VAT.

5.2.3 Corporate Income Tax on Liquidation Income

If, after a business transfer, the transferor company is liquidated, the liquidating company may be subject to corporate income tax on the “liquidating income”.

5.2.4 Income Tax on Shareholders’ Unrealised Gains as Deemed Dividends

When a corporation is liquidated and the remaining assets are distributed to shareholders, to the extent the proceeds received by a shareholder exceed the acquisition price for its shares, the shareholder would be deemed to have received the excess as dividends.

Korean corporate shareholders must include such deemed dividends when calculating their taxable income.

Foreign corporate shareholders will be subject to Korean withholding tax on the deemed dividends (assuming the dividend is not connected with a PE of the foreign shareholder in Korea). The rate of withholding tax on such dividends under Korean domestic law is 27.5%. However, the tax rate may be reduced under an applicable double tax treaty between Korea and the resident jurisdiction of the foreign shareholder.

6. Mergers

Mergers are legally allowed in Korea, but only between Korean domestic companies.

6.1 Tax Consequences

Unless carefully planned and executed, a Korean merger may result in a Korean tax liability for the dissolving company, shareholders of the dissolving company, and/or the surviving company as mentioned below.

However, through careful planning and agreement among the shareholders, substantially all of the merger-related taxes may be mitigated or deferred, particularly if the merger is considered a "Qualified" merger, as further outlined below.

A merger meeting the following basic conditions will be considered a "Qualified Merger" for Korean tax purposes:

- both involved companies – surviving and dissolving (merged) companies, have been engaged in business for one year or longer as of the merger date;
- if consideration is paid, at least 95% of the consideration paid to the shareholders of the merged company consists solely of shares in the surviving company; and
- the surviving company continues to carry out the operations of the transferred business until the end of the fiscal year in which the merger takes place.

6.1.1 Tax Implications for Target Company (Dissolving Company)

Liquidation income may result when a Target Company in a merger is liquidated in connection with the merger into the surviving company. Generally, liquidation income (calculated at the Target Company level) is the amount of the excess of the adjusted net equity of the dissolving company. Such income is subject to the regular corporate income tax (generally 27.5%) in the hands of the Target.

6.1.2 Tax Implications for Shareholders of the Target

Where the proceeds (surviving company's shares, cash and other consideration) received by the target's shareholders exceed the acquisition costs of such shares, the difference will generally be treated as a deemed dividend for Korean tax purposes. Deemed dividend income to a Korean corporate shareholder is included in its taxable income. Generally, deemed dividend to a foreign shareholder is subject to withholding tax at 27.5%, or lower treaty rate, if applicable.

6.1.3 Tax Implications for Surviving Company

- Registration Tax

  In the case of a merger, an exemption from registration taxes may be available for the registration of certain properties acquired in a merger between companies that have been in existence for at least one year.

- Acquisition Tax

  Assets acquired in a merger should generally be exempt from acquisition tax which ranges from 2.2% to 11%.

- Corporate Tax on Appraisal Gains

  If in the course of a merger, the surviving company records assets transferred from a merged company at an appraised value that is in excess of the book value of the dissolved company, such appraisal gain would normally be treated as taxable income for the surviving company. However, in a "Qualified Merger", the corporate income tax on gain resulting from the appraisal of real estate assets may be deferred until the surviving company disposes of such assets. Nevertheless, it should be noted that if the surviving company discontinues the business of the dissolved company within three years of the merger, the deferred income will be recaptured for tax purposes at that time, regardless of whether the assets are sold.

- Others

  – Unfair Mergers

    If the stock exchange ratio between related companies is manipulated in such way that one of the shareholders obtains a disproportionate economic advantage, the transferor of the benefit (Donor) is subjected to the "Denial of Unfair Transactions" and the benefitting party (Beneficiary) is subject to the "Tax on Deemed Income from Unfair Transaction".

  – Succession of Tax Attributes

    Certain tax attributes of the dissolving company could be transferred to the surviving company.

  – Succession of Net Operating Loss (NOL)

    If certain conditions under tax laws are met, the NOL of the dissolving company could be transferred to the surviving company.

7. De-mergers

De-merger structures may involve various tax implications and must be carefully designed to minimise potentially negative tax consequences. For example, Korean tax rules permit various tax benefits in split-offs (and spin-offs) that satisfy certain requirements (qualified split-off requirements). The qualified split-off/spin-off requirements are as follows:

- the divided company must be a domestic company which has been in business for at least five years prior to the split-off registration date;
- 100% of the consideration received by the divided company's shareholders must be in shares of the new split-off company, and must be distributed in proportion to the shareholders' ownership ratio;
- the split-off company must be a business unit which is capable of carrying on its business wholly on its own, and the assets and liabilities of the divided business unit(s) must be comprehensively transferred to the split-off company;
- the split-off company must carry on the historic business of the divided company until the end of the taxable year in which the split-off occurred.

7.1 Type of De-mergers

- Split-off (*Injuk-boonhal*)

  A split-off is defined as the separation of a company's business division to a new entity as subsidiary of the company's parent or shareholders.

- Spin-off (*Muljuk-boonhal*)

  A spin-off is defined as the separation of a company's business division to a new entity as subsidiary of the company

7.2 Split-off

7.2.1 Acquirer

- Deemed Dividend Income

  This tax normally applies to shareholders of a spun off company which receives compensation of a spin-off.

7.2.2 A New Split-off Company

- Tax on Appraisal Gains

  Appraisal gains (i.e. appraisal value of assets transferred less their book value) may be recognised from a split-off. However, if the requirements for a qualified split-off are met, tax on such gains may be deferred.

- Transfer of Tax Attributes

  All tax attributes could be transferred to the new company, provided that it satisfies requirements for a qualified split-off and the assets are transferred at book value of the parent company

- Acquisition/Registration tax

  In general, 2.2% acquisition tax and 2.4% registration tax would be payable by a new split-off company (in the case of Seoul Metropolitan area, triple rate may apply). However, if the requirements for a qualified split-off are met, these taxes may be exempt.

7.2.3 Target (From Which a New Company is Split Off)

- Capital Gains Tax

  Capital gains (i.e. consideration received by target less amount of capital reduction at target) would be recognised upon split-off.

7.3 Spin-off: Tax and Other Considerations

7.3.1 A New Spun-off Company

- Acquisition/Registration Tax

  In general, 2.2% acquisition tax and 2.4% registration tax would be payable by a new spun-off company (in the case of Seoul Metropolitan area, triple rate may apply). However, if the requirements for a qualified spin-off are met, these taxes may be exempt.

- Transfer of Tax Attributes

  Certain tax attributes could be transferred to the new company.

7.3.2 Target (From Which a New Company is Spun Off)

- Gains from the Transfer of Asset

  In the case of a spin-off, if the consideration for the transferred asset and liabilities to the new company exceeds the book value of the parent company, such gains would normally be treated as taxable income for the parent company. However, if the requirements for a qualified split-off are met, these taxes may be deferred.

  It should be noted that there exists a risk of potential double taxation because capital gains from asset transfer upon spin-off would be taxed at the target's level and dividends later distributed to the target's shareholder would also be taxed at the shareholder's level.

8. Other Pertinent Issues

8.1 Exit Route

The Korean government has in recent years opened up its economy to encourage foreign investments. Before entering a deal to acquire an investment in Korea, a foreign buyer would need to consider its investment strategies and if applicable, the exit strategies. As indicated, an asset deal will result in a host of tax issues to the seller whereas a share deal may be structured more tax effectively.

Therefore, by selecting an appropriate buying entity for a Korean Target, a foreign investor may exit Korea with a relatively reduced tax cost.