

Taxation on the Stock Transfer of Domestic Corporation (in Korea) between Foreign Corporations

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I. Overview

The Foreign Corporation 'B' (located in China) which is holding whole capital stocks of Domestic Corporation 'A' plans to transfer all those stocks to its subsidiary, Foreign Corporation 'C' (located in Virgin Islands). The Taxation matter on this case by Tax authority in Korea and the process of the security transfer will be reviewed here with relative statute.

II. Review

1. Tax on Capital Gains

1) Non-Taxable Income

It is regarded as a domestic source income under the Article 93 in Corporate Tax Act in Korea when the Foreign Corporation 'B' (located in China) transfer the shares of Domestic Corporation 'A'. But it is not taxable income under the Article 13 in Tax Treaty between Korea and China (Article 93-9 in Corporate Tax Act, Article 13-5 in Tax Treaty between Korea and China)

2) Application for Tax Exemption

As per the Tax Treaty, it will be regarded as a Tax Exemption case. In order to be exempt from the income tax, the transferee, upon the verifying the domestic source income actually accrued, should submit the application with a transferor's resident certificate issued by the authorities of country in which the transferor is located, to the head of a tax office having the jurisdiction over the place of tax payment of the income payer, by the 9th day of the following month of a day on which the income is paid. (Article 138-4 in Enforcement Decree of the Corporate Tax Act)

3) Check Point

Having the taxation right on the Capital Gains by local authority, it is not important issue on the transfer value, but the matter of being a constructive Gift should be considered. In case it is a local transaction, it will be issued as the constructive Gift when it is upper or undervalued. Considering as a foreign transaction, if the transferee is profit-making corporation, the Gift tax is not to be levied for this transaction under the 'Inheritance Tax and Gift Tax Act' in Korea. But in case the transferee is Non-resident or Non-profit making corporation, the relevant details should be reviewed.

2. Securities Transaction Tax

1) Taxable Income

Having no stipulated in the Tax Treaty, the securities transaction tax is to be levied on the transaction, 0.5% of the arm's length price regardless of the Transfer value (Article 7 & 8 in Security Transaction Tax Act).

2) Process for Tax Payment

The Foreign Corporation which has no place of business in Korea, transfers share certificates, etc., not through any financial investment business operator, the transferee of such share certificates, etc. shall be the

taxpayer. (Article 3 in Security Transaction Tax Act).

The foreign corporation which has no place of business in Korea, the location of the head or principal office of the corporation which has issued the share certificates on which the securities transaction tax is levied. (Article 4 in Security Transaction Tax Act).

The filing and payment of the tax amount of each quarter due date is within two months from the last day of the quarter to which the transfer date belongs. (Article 10-1-2 in Security Transaction Tax Act)

3. Judgment on the Gift of domestic asset

- 1) Having the taxation right on the Capital Gains by local authority, the transfer value could be decided at the discretion of the party concerned. But it should be carefully considered that, as per the principle of substantial taxation, it could be taxable as a Gift income if the transfer is undervalued or no valued at all, (Article 92-10-c in Corporate Tax Act)
- 2) The transfer contract and bank payment certificate should be secured and submitted.

III. The Relative Statute

Corporate Tax Act

Article 93 (Domestic Source Income)

Domestic source income of a foreign corporation shall be classified as follows: <Amended by Act No. 11128, Dec. 31, 2011>

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9. Income prescribed by Presidential Decree and accrued from the transfer of any of the following stocks, etc. (including real estate stocks, etc. listed on any securities market under the Financial Investment Services and Capital Markets Act), or other securities (including securities as defined in Article 4 of the Financial Investment Services and Capital Markets Act; hereinafter the same shall apply):

- (a) Stocks, etc, and other securities issued by a domestic corporation;
- (b) Stocks, etc. issued by a foreign corporation (limited to those listed on any securities market under the Financial Investment Services and Capital Markets Act), and other securities issued by a domestic place of business of a foreign corporation;

10. Any of the following income, other than those provided in subparagraphs 1 through 9:

- (a) Insurance money, compensation, or damages paid in connection with any real property or other assets situated in Korea, or business run in Korea;
- (b) Income prescribed by Presidential Decree as penalties for breach of any contract or compensation for damages paid in Korea;
- (c) Income accrued from the inheritance of domestic assets;

Corporate Tax Act

Article 92 (Calculation of Amount of Domestic Source Income)

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- (2) The amount of domestic source income of a foreign corporation falling under Article 91 (2) and (3) for each business year, other than capital gains on transfer provided in subparagraph 7 of Article 93, shall be the amount under the following subparagraphs: <Amended by Act No. 11128, Dec. 31, 2011>
1. Domestic source income provided in subparagraphs 1 through 6 and 8 through 10 of Article 93 shall be the revenue amount by income provided in each subparagraph (excluding subparagraph 7) of the same Article: provided that the domestic source income provided in subparagraph 9 of Article 93 may be replaced by an amount computed by deducting the acquisition value and transfer expenses of the relevant securities verified, as prescribed by Presidential Decree, from the revenue amount;
 2. Where the domestic source income referred to in subparagraph 9 of Article 93 of a foreign corporation with no domestic place of business meets the following conditions, the arm's length price prescribed by Presidential Decree (hereafter referred to as "arm's length price" in this subparagraph) shall be the revenue amount of the foreign corporation, notwithstanding subparagraph 1:
 - (a) Income accruing from transactions between a foreign corporation with no domestic place of business and a foreign corporation (including non-residents) having a special relationship prescribed by Presidential Decree with the former foreign corporation;
 - (b) Prices of transactions provided in item (a) fall short of the arm's length price in circumstances prescribed by Presidential Decree.

Tax Treaty (Korea-China)

Article 13 (Capital Gains) [1994.09.28]

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other Contracting State.
2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in that other Contracting State
3. Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State which the place of head office or effective management of the enterprise is situated.
4. Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that Contracting State.
5. Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State of which the alienator is a resident.

Enforcement Decree of the Corporate Tax Act

Article 138-4 (Application for Non-Taxation or Tax Exemption in Tax Treaty by Foreign Corporation)

- (1) Any person or foreign corporation, to whom the domestic source income actually accrues, which intends to apply for non-taxation or tax exemption under Article 98-4 of the Act shall submit an application for non-taxation or tax exemption, prescribed by Ordinance of the Ministry of Strategy and Finance, (hereinafter referred to as "application for non-taxation or tax exemption" in this Article) to an income payer, and the relevant income payer shall submit the application to the head of a tax office having the jurisdiction over the place of tax payment of the income payer, by the 9th day of the following month of a day on which the first income is paid. <Amended on Jun. 8, 2009; on Feb. 18, 2010; on Dec. 30, 2010, on Feb. 21, 2014>
- (2) The application for non-taxation or tax exemption shall be accompanied by a resident certificate issued by the authorities of country in which the relevant foreign corporation is located, or documents determined and publicly notified by the Commissioner of the National Tax Service. <Amended on Jun. 8, 2009; on Feb. 18, 2010; on Dec. 20, 2010>

SECURITIES TRANSACTION TAX ACT

Article 3 (Taxpayer)

Person who falls under any of the following subparagraphs shall be taxpayers of securities transaction tax: <Amended by Act No. 5156, Aug. 14, 1996; Act No. 6302, Dec. 29, 2000; Act No. 9274, Dec. 26, 2008>

1. Where transaction of share certificates falling under any of the following items is settled by transfer between accounts, the Korea Securities Depository (hereinafter "Securities Depository") established under Article 294 of the Financial Investment Services and Capital Markets Act;
 - (a) Share certificates transferred on the securities market; and
 - (b) Share certificates transferred outside of the securities market by a method prescribed by Presidential Decree;
2. Where share certificates, etc. are transferred through a financial investment business operator under Article 8 (1) of the Financial Investment Services and Capital Markets Act (hereinafter "financial investment business operator") in addition to cases under subparagraph 1, the relevant financial investment business operator; or
3. Where share certificates, etc. are transferred except the cases as provided in subparagraphs 1 and 2, the transferor of the relevant share certificates, etc.: provided that where a non-resident of foreign corporation that does not have any place of business in Korea transfers share certificates, etc., not through any financial investment business operator, the transferee of such share certificates, etc. shall be the taxpayer.

SECURITIES TRANSACTION TAX ACT

Article 4 (Place of Tax Payment)

- (1) The place where the securities transaction tax is to be paid shall be any of the following places: <Amended by Act No. 6302, Dec. 29, 2000>
 1. In cases referred to in subparagraphs 1 and 2 of Article 3, the location of each place of business of the relevant taxpayer: provided that in cases prescribed by Presidential Decree, the location of the head office or principal office may be made as the place of payment for securities transaction tax; or
 2. In cases referred to in subparagraph 3 of Article 3:
 - (a) If the taxpayer is a resident, his/her domicile: provided That if he/she has no domicile, ti shall be his/her residence;

- (b) If the taxpayer is a domestic corporation, the location of is head or principal office recorded in the register;
- (c) If the taxpayer is a non-resident or foreign corporation and has a place of business in Korea, the location of such place of business (if he/she has two or more places of business in Korea, the principal one); or
- (d) If the taxpayer is a non-resident or foreign corporation and has no place of business in Korea, the location of the head or principal office of the corporation which has issued the share certificates on which the securities transaction tax is levied.

SECURITIES TRANSACTION TAX ACT

Article 7 (Tax Base)

- (1) The tax base of securities transaction tax shall be as follows: <Amended by Act No. 8838, Jan. 9, 2008>
 - 1. Where the share certificate under each item of subparagraph 1 of Article 3 are transferred, the sum of the transfer value of relevant share certificates; and
 - 2. Where the share certificates, etc. other than subparagraph 1 are transferred, the value under the division falling under each of the following items:
 - (a) Where the transferred values of share certificates, etc. are known: the transferred values of relevant share certificates, etc.: provided that in cases under any of the following sub-items, the following value shall be the tax base:
 - (i) The relevant market value in cases where acknowledged that the share certificates, etc. have been transferred at the price lower than the market value under Article 101 of the Income Tax Act, Article 52 of the Corporation Tax Act, of Article 35 of the Inheritance Tax and Gift Tax Act (except the cases where the provisions of Article 4 of the Act for the Coordination of International Tax Affairs shall apply); and
 - (ii) The normal value in case where acknowledged that the share certificates, etc. have been transferred at the price lower than the normal value under Article 126 of the Income Tax Act, Article 92 of the Corporation Tax Act or Article 4 of the Act for the Coordination of International Tax Affairs;

SECURITIES TRANSACTION TAX ACT

Article 10 (Tax Return, Payment and Refund)

- (1) Any taxpayer of securities transaction tax shall file a return of tax base and tax amount according to the classification if the following subparagraphs with the director of a competent tax office as prescribed by Presidential Decree: <Amended by Act No. 5156, Aug. 14, 1996; Act No. 9274, Dec. 26, 2008>
 - 1. To file a return of tax base and tax amount of each month by tenth of the next month in the cases under subparagraphs 1 and 2 of Article 3; and
 - 2. To file a return of tax base and tax amount of each quarter within two months from the last day of the quarter to which the transfer date belongs in the cases under of subparagraph 3 of Article 3.

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