

**Review of Seoul Japan Club's Recommendation (April 29, 2011, Friday)**

**<Summary>**

No.	Name of item	Division of jurisdiction	Results of review
1	<b>Regarding Japanese companies due to Japan's natural disaster</b> ① Postponement of tax investigation ② Extension of deadline for reporting and paying corporate tax	Policy National Tax Service/Korea a Customs Service	Being implemented
2	<b>Inclusion of donation for Japanese Great Disaster as deductible expenses</b>	Corporation	Being implemented
3	<b>Reducing burden ratio of Foreign Exchange Stabilization Fund</b>	Foreign Exchange System	Difficult to accept
4	<b>Regarding support for SMEs</b> ① Increasing definition of SMEs ② Postponement of special tax exemption on SMEs	Special Taxation	① Difficult to accept ② Reviewed during this year's tax reform
5	<b>Ease of conditions for inclusion of bad debt expenses as deductible expenses</b>	Corporation	Difficult to accept
6	<b>Exclusion of taxation on stock transfer margin of domestic affiliates during merger/division with overseas head office</b> ① Legal amendment (system) ② Amendment of treaty or exchange of bilateral documents (cooperation)	National Bid National Cooperation	Carefully being reviewed

1. Support on tax administration for Japanese companies that had suffered from the damages of Japanese Great Earthquake			

**1. Contents of recommendation**

Present status	Details
<p>□ In the case where there are serious business difficulties on the taxpayer due to reasons of natural disasters</p> <p>○ Allowed to postpone tax investigation for taxpayers who apply for it (7② of §81 of the Framework Act on National Taxes)</p> <p>○ Allowed to extend the deadline for reporting, application, etc. if taxpayers apply for it (§6 of the Framework Act on National Taxes)</p>	<p>□ Since it is difficult to receive normal support from the head office due to the recent natural disaster in Japan, in the case of Japanese companies</p> <p>① Postpone tax investigations</p> <p>② <b>Extend the deadline for reporting and paying corporate taxes, etc. for a certain period of time</b></p>

**2. Review opinion: Being implemented**

**① Postponement of tax investigations (national taxes) and corporate review (customs duty)**

□ (National taxes) Currently, the applicable investigative authorities are reviewing the applications requesting for postponement of tax investigations

○ The approval of each application is determined individually considering the level of business difficulty, etc. (Investigation Planning Division, National Tax Service)

□ **(Customs duty)** Corporate review is postponed until the end of this year for amount of tax payment and tax return, as well as customs appropriateness, by judging the level of damages

※ **Announced and implemented “the Support Measures for Tax Administration Regarding Japanese Great Earthquake” after the earthquake in Japan**

## ② Extension of deadline for reporting and payment

□ **(National tax)** Regarding tax payers who are experiencing difficulties, such as liquidity, due to the recent Japanese Great Earthquake, active support on tax administration has been provided during the reporting of corporate taxes in March, including the postponement of the deadline for reporting\*.

○ In the case where foreign investment companies and foreign corporations that suffered damages from the recent Japanese Great Earthquake find it difficult to report or pay taxes due to natural disasters or business crises, it is possible to extend the deadline for tax reporting and payment.

\* During March, the Tax Collection Division of National Tax Services provided official documents stating ‘actively examine the postponement of the deadline for reporting in the case of Japanese companies that suffered damages from the Japanese Great Earthquake under the current system’ for taxes and customs.

○ Continuous support on tax administration will be provided within the permitted limit under the tax laws regarding various tax reporting and payment, including expected reporting of VAT and reporting of corporate taxes (end of March for corporations).

□ **(Customs duty)** Support on tax administration will be provided for companies with damages, including the postponement of deadline, the payment by installment, and the special support of return of export duties.

## 2. Inclusion of donation as deductible expenses

### 1. Contents of recommendation

Present status	Details
<ul style="list-style-type: none"><li>□ Scope of legal donation</li><li>○ Amount of relief goods for victims of natural disasters</li></ul>	<ul style="list-style-type: none"><li>□ Clarification on the scope of legal donation</li><li>○ Recognize all amount of relief goods for victims of natural disasters as legal donation regardless of the entity of collecting donation</li></ul>

### 2. Review opinion: Being implemented (However, complement insufficient areas during execution)

□ Currently, the amount of relief goods for victims of natural disasters is recognized as legal donation.

○ The amount of relief goods for victims of overseas natural disasters also fall under this (General rules 24-3-3)

□ However, in the case where the relief goods for victims of overseas natural disasters are handed to that country through a Korean institution of donation collection,

○ There are confusions as to who is the entity that issued the receipts for the donation, which is why a clear standard could not be provided by the National Tax Service.

⇒ Therefore, we plan to complement insufficient areas during execution by cooperating with the National Tax Service.

## 3. Easing the burden ratio of Foreign Exchange Stabilization Fund

## 1. Contents of recommendation

Present status	Details
<ul style="list-style-type: none"><li>□ Levy burden charges by multiplying the burden ratio to the non-deposit foreign currency debt of financial institutions</li><li>○ (burden ratio) differentiation by maturity</li></ul> <p>* 20bp for less than 1 year, 10bp for 1~3 years, 5bp for 3~5years, and 2bp for exceeding 5 years</p>	<ul style="list-style-type: none"><li>□ Since the burden ratio is high for foreign currency borrowing because the domestic branches of foreign financial institutions bear the burden compared to domestic financial institutions,</li><li>○ Please reduce the burden ratio</li></ul>

## 2. Review opinion: Difficult to accept

- The Foreign Exchange Stabilization Fund was introduced to ease the rapid fluctuation of capital inflow and outflow due to excessive borrowings of domestic banks.

- Therefore, the burden charge is applied on domestic commercial banks and foreign bank branches without discrimination.

- The high burden ratio of foreign bank branches is due to their characteristic of high proportion of foreign currency borrowings.

- However, there will be consideration of the special characteristic of foreign bank branches when making decisions on detailed items of levy\*

\* Burden charges will be levied on all items (foreign currency borrowings, etc.) excluding the deposits in foreign currency among the foreign currency debts for foreign exchange account, while it is expected that decisions will be made through the notification of the Minister of Strategy and Finance after July 2011.

- There are plans to exempt taxes on long-term funds raised from the head office of foreign bank branches.

**4-①. Definition of SMEs in the Framework Act on SME**

1. Contents of recommendation

Present status	Details
<ul style="list-style-type: none"> <li>□ Independence of SMEs               <ul style="list-style-type: none"> <li>○ An affiliate that is invested more than 30% by a corporation of more than KRW 500 billion in total asset amount is excluded from SMEs (§2① of the Enforcement Decree of the Tax Reduction and Exemption Act)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>□ Easing the independence condition of SMEs               <ul style="list-style-type: none"> <li>○ Regarding Korean affiliates that have been invested more than 30% by a foreign corporation with more than KRW 500 billion in total asset amount,                   <ul style="list-style-type: none"> <li>- Recognize the exclusion to attract prospective foreign SMEs</li> </ul> </li> </ul> </li> </ul>

**2. Review opinion: Difficult to accept**

- Regarding the judgment of the independence for the scope of SMEs,
  - When judging the independence of SMEs, the target of a mother company of more than KRW 500 billion in total asset amount is applied on domestic and foreign corporations without discrimination.
  
- If the standard for judging the independence of SMEs is only excluded for foreign mother companies, it will be unfair to domestic companies.

\* Basically, the Tax Reduction and Exemption Act follows the Framework Act on SME for the independence standard of SMEs, while the actual independence is judged under the Framework Act on SME, including foreign mother companies (§3(1) of the Enforcement Decree of the Framework Act on SME)

4-②. Extension of exemption on special taxation on SMEs

**1. Contents of recommendation**

Present status	Details
<ul style="list-style-type: none"> <li>□ System for exemption on special taxation for SMEs</li> <li>○ (target business type) 39 business types, including manufacturing industry</li> <li>○ (exemption ratio) 5 ~ 30%*</li> <li>* Differentiation between small companies and medium companies</li> <li>○ (sunset) December 31, 2011</li> </ul>	<ul style="list-style-type: none"> <li>□ Extension of system for exemption on special taxation for SMEs</li> <li>○ (same as left)</li> <li>○ (same as left)</li> <li>○ <b><u>Extension for sunset</u></b></li> </ul>

**2. Review opinion: under review during this year's tax reform**

□ Regarding the extension of sunset for the system for exemption on special taxation for SMEs

○ the decision on whether or not to extend will be determined through comprehensive consideration during this year's tax reform, including the purpose of tax exemption and expected policy effect from tax exemption.

5. Condition for inclusion of bad debt expenses as deductible expenses

**1. Contents of recommendation**

Present status	Details
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<ul style="list-style-type: none"> <li>□ Inclusion of bad debt expenses as deductible expenses</li> <li>○ Bonds that completed extinctive prescription</li> <li>○ Certain bonds that passed more than 6 months from the date of debt occurrence</li> <li>○ Bonds of certain debtors</li> <li>* Irrecoverable bonds due to the debtor's bankruptcy, compulsory execution, execution of sentence, business suspension, death, disappearance, and missing</li> <li>○ Among bonds with recovery dates that passed more than 6 months, bonds of less than KRW 200,000 in bond price</li> </ul>	<ul style="list-style-type: none"> <li>□ Increase the scope of the inclusion of bad debt expenses as deductible expenses</li> <li>○ In the case where it is clear that the whole amount cannot be recovered based on the debtor's asset status and payment ability,</li> <li>○ In the case where the total bond amount for account receivables does not meet collection cost,</li> <li>○ In the case where the status of the debtor not paying the debt on monetary claim for certain period of time, where it has been recognized that the monetary claim cannot be repaid, and where the waiver of an obligation on the debtor has been clarified in writing</li> </ul>
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## 2. Review opinion: Difficult to accept

### □ (Against the general rules of tax laws) Against the tax laws and regulations regarding bad debts

○ In order to levy fair and appropriate taxes, the tax laws does not recognize cost on estimation unlike accounting standards and only recognizes cost from the time when the obligation is confirmed (decisions of claim basis).

○ Currently, there is a strict restriction on the conditions for inclusion of bad debts as deductible expenses\*, if a subjective and arbitrary bad debt standard is adopted, there are concerns that it will hinder the fairness of taxation and create tax evasion.

\* Regarding reasons that are stated in the Presidential Decree, including the completion of extinctive prescription, bankruptcy, death, compulsory execution, and 6 months after bankruptcy

□ (sufficient support being provided) Despite the decisions of claim basis as the principle of tax laws, if the allowance for bad debts is established, deductible expenses are recognized within the limited scope as exclusion\*

\* Major advanced countries, including the US, Britain, Germany, and Japan, only recognize the inclusion as deductible expenses in the case where actual bad debts occur and the allowance for bad debts is not recognized under the tax laws.

○ Therefore, it is possible to accumulate an appropriate allowance that reflect the ratio of actual bad debts through the standard for actual ratio of bad debts, which means there isn't actual profit that accumulate bad debts by reflecting the payment capability of debtor.

※Limit for the inclusion of bad debts as deductible expenses

- Financial institution: maximum (2%, actual ratio of bad debts, accumulation standard of Financial Supervisory Commission)

- Other corporations: maximum (1%, actual ratio of bad debts)

\* (Actual ratio of bad debts) bad debts of applicable business year/current bond balance on the finishing date of previous business year

\* (Accumulation standard of Financial Supervisory Commission) accumulation standard for the allowance of bad debts established through consultation between the Financial Supervisory Commission and the Ministry of Strategy and Finance.

6. Exclusion of taxation on stock transfer margin of domestic affiliate during merger/division with foreign head office

#### 1. Details of recommendation

Present status	Details
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<p>□ In the case where the stocks of domestic owned by foreign head office are transferred due to merger and division with foreign head office</p> <p>○ Taxation according to the individual transfer of marketable securities</p>	<p>○ Despite the perfunctory transfer of assets according to restructuring, exclusion of taxation by not seeing it as transfer</p> <p><b>- Amendment of laws or tax treaty*</b></p> <p><b>* Also, exchange of documents through bilateral negotiation</b></p>
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## 2. Review opinion

### ① Amendment of laws: **Carefully being reviewed**

□ **Currently, it is difficult to adopt tax support on stock transfer of domestic affiliates resulting from restructuring, including merger and division of foreign corporations.**

○ The Korean tax laws postpones the transfer margin for merger and division for domestic corporations as an exception.

\* Finality of business, continuity of shares, consistency of business, etc.

- This is aimed to support the restructuring of domestic corporations to improve management efficiency, but it is difficult to apply also to foreign corporations.

- In the case of Japan, there are also tax support for merger and division between domestic corporations with limited exception.

○ Also, the postponement of taxation appropriates the allowance during merger and division after the inclusion of transfer margin as deductible expenses (excluding taxation), which is later included in expenses during the transfer timing (taxation).

- In the case of foreign corporations without domestic work sites, there is the problem of difficulty in post-management, including appropriateness of allowance.

□ In particular, the same case is pending trial at the Korean Supreme Court.

○ It is necessary to consider that in the legal interpretation of National Tax Service and the first trial and appeals trial of court have all decided on taxation.

② Amendment of tax treaty, etc.: **Carefully being reviewed**

□ It is difficult to exchange official documents of detailed contents on the treaty, such as taxation on stock transfer.

○ There are no examples of exchanging official documents on taxation rights that are not in the main text of the treaty.

○ Basic stance that it is not appropriate to actually amend the treaty like this (changing the determination of taxation).

□ Careful review is required because there are almost no cases where the taxation right of the country of collection on stock transfer has been restricted as a condition for restructuring among the current tax treaties.

\* The amended protocol signed with Switzerland in December 2010 recognized the taxation right of the location of the real estate for stocks on real estates, which restricted taxation on transfer income during stock transfer for restructuring.