Yonsei University

From the SelectedWorks of Mee-Hyon Lee

October, 2013

Korean Tax Policy Favors Increasing Progressivity

Mee-Hyon Lee, Yonsei University

Available at: http://works.bepress.com/mee-hyon_lee/2/
Korean Tax Policy Favors Increasing Progressivity

I. Introduction

During the period between 2007 and 2008, a number of tax reforms were effectuated in Korea with the goal of refining the tax system into one that is simpler, fairer and more pro-growth. There have been efforts to reduce income tax rates for both corporations and individuals, and to provide predictability, and advance ruling system has been adopted in October 2008\(^1\). All these efforts were geared toward creating a more favorable investment and business environment, while also encouraging more consumption and job creation. However, with the growing demand for increased social welfare benefits which started to surface in recent years, the welfare budget demands started to increase steeply. As a result, since 2009, maintaining the nation’s fiscal soundness has become another major goal of Korean tax policy. Against this backdrop, a large portion of recent tax amendments in Korea have been geared towards collecting more taxes to increase tax revenue and this article covers some of those recent changes having rather significant impact on the economy and eventually on the taxpayers.

II. Background for Recent Trend

A. Growing Demand for Social Welfare Benefits

For the past decade, one of the hottest social debates discussed in Korea has been to whom and to what extent the social welfare benefits should be extended. There has been demands for expanding the scope of social welfare benefits all along for a long time, however, due to a rather radical change in social environments in Korea these days, the voice demanding more social welfare benefits has become larger than ever. Although such trend is an outcome of many complex causes, the major driving factors may be summarized as the low economic growth rate, collapse of middle class and the ageing society.

\(^1\) See Articles 16 through 26 of the 「Regulation on Administration of Affairs pursuant to Relevant Laws and Regulations」 (bupryung-samu-chuhri-gyujung in Korean), the internal regulation of the National Tax Service for the detailed procedures of the advance ruling system.
(1) Low Economic Growth Rate

Korea experienced a very fast economic growth during 1970’s and 1980s’, the average economic growth rate being around 10% during this period. Even in the 90’s, the economic growth rate was usually above 8%. Since the outbreak of Asian financial crisis in 1997, however, the growth rate began to fall down as shown in the graph\(^2\) below.

\[\text{Graph showing economic growth rate from 1997 to 2012.}\]

In 2012, it was only 2% and the outlook for 2013 is not very bright. The Korea Institute for Industrial Economics & Trade predicts the economic growth rate in 2013 to be 2.7%\(^3\). Currently, the Korean economy is stuck on a plateau of slow growth, which is inevitably accompanied by increasing unemployment. According to the statistics officially published by the Statistics Korea\(^4\), the unemployment ratio as of May 2012 was 3% and the unemployment ratio for young generation\(^5\) is 7.3%. These numbers are still low compared to other OECD countries, however, it should be noted that according to the method used by the Statistics Korea, discouraged workers are considered as “economically inactive population”, thus resulting in lower number of unemployment ratio than it should be. The number of “economically inactive population” has dramatically increased from

---

\(^2\) This graph is based on the data taken from the website of the Bank of Korea Economic Statistics System (http://ecos.bok.or.kr) under the category of 100 Statistic Indices, accessed July 15, 2013.


\(^5\) “Young generation” refers to age between 20–29.
14 million in 2000 to almost 16 million in 2012. Given these, if the unemployment ratio is recalculated counting so-called “discouraged workers” as “economically active population”, the unemployment ratio so calculated would be substantially higher than 3%.

(2) Collapse of Middle Class

During the Asian crisis, a lot of small and medium sized enterprises went bankrupt leading to a serious collapse of the middle class people in Korea. By the time Korea overcame the Asian crisis, the gap between the rich and the poor became wider than ever, which led to a serious polarization of wealth problem the Korean society is suffering at the moment.

(3) The Aging Society

Another serious problem Korean society is currently facing is the aging society problem. In terms of aging of population, Korea is one of the fastest countries in the world. The proportion of the aged population against the whole population is dramatically increasing these days. The ratio of the population over 65 years old over the total population was 7.2% in 2000 but now it is 11.4% and it is expected to reach 15.7% in 2020.

Given these circumstances, it is more than natural that the voice demanding “distributive justice” is becoming louder and louder.

B. Social Welfare Budget on the Rise

With such increased demand for social welfare benefits, it is more than natural that Korea’s welfare budgets have been increasing steeply. As shown in the graph below, the social welfare budget rose steeply from 49.6 trillion Korean Won in 2005 to 92.6 trillion Korean Won in 2012. As a result, the proportion of the social welfare budget over the gross national expenditure increased from 23.7% in 2005 to 28.5% in 2012. Also, we can see from the graph that while the average annual increase of the gross national expenditure was 6.5% during the period between 2005 and 2012, the average annual increase of the social welfare budget reached

---

6 To be more precise, from 14,052,000 in 2000 to 18,081,000 in 2012. See the KSIS website, note 4 above.
7 Some people assert that it would go up to as high as 8%.
8 See the KSIS website, note 4 above.
9 This graph is re-quoted from the graph at 187 of 「2012 Fiscal Notes」published by the National Assembly Budget Office.
9.3% during the same period. This means, the social welfare budget increased more steeply compared to the national budget increase.

The graph below compares the changes of the social welfare expenditure and the GDP during 2005 and 2011. It shows that proportion of the social welfare budget over GDP has been continuously increasing, it being 5.7% of the GDP in 2005 but 7% of GDP in 2011.

This graph is re-quoted from the graph at 187 of 「2012 Fiscal Notes」published by the National Assembly Budget Office.
From these graphs, we can infer that the social welfare budget increase has been one of the major factors driving increase of the gross national expenditure over the recent years. This year, the total national budget has increased by around 5.1% compared to that of last year, amounting to approximately 342 trillion Korean Won (KRW342,000,000,000,000) and the national social welfare budget for 2013 is approximately 97.4 trillion Korean Won (KRW97,400,000,000,000), amounting to 28.5% of the total national budget.  

With such a steep increase of gross national expenditure, maintaining the nation's fiscal soundness has become one of the most important goals of Korean tax policy. Hence, it is not surprising that recent tax reformation was geared towards collecting more taxes, especially from those high income individuals and conglomerates.

III. Income Tax Act Changes – More Taxes for High Income Bracket Individuals

As a result of the attempts starting in 2008 to reduce tax burdens as part of moves toward creating a more favourable investment and business environment and also encouraging more consumption and job creation, Article 55, paragraph 1 of the Income Tax Act of Korea was amended by the end of 2008 to lower the income tax rate of the highest bracket from 35% to 33%. (“2008 Income Tax Amendment”), the amended rate to become applicable for the income accrued on or after January 1, 2010. However, 2008 Income Tax Amendment was fiercely challenged by the opposition parties as a tax reduction benefiting the rich only. Further, as the need to increase tax revenues grew due to the recent social atmosphere demanding more and more social welfare benefits, income tax reduction became a wedge issue even among the ruling party. By the middle of 2009, even some members of the National Assembly belonging to the ruling party began to assert that the effective date of the contemplated tax reduction should be deferred for some time. A number of high-ranking government officials also expressed opinions stringing along therewith. As a result, just before the tax reduction contemplated

---


12 Article 55, paragraph 1 was amended on December 26, 2008 to insert a new sub-paragraph 2 setting forth the lowered rate. It was contemplated that the original sub-paragraph 1 would apply for the income accrued only up to December 31, 2009 and the new sub-paragraph 2 would apply for any income accrued on or after January 1, 2010.

13 During an interpellation session at the National Assembly on June 29, 2009, Mr. Yoon Jeung-Hyun, the Minister of Strategy and Finance at that time, said that he thought it was worthwhile to positively consider postponing the effective date of the tax reduction for some time. See newspaper article of The Hankook Ilbo dated June 30, 2009. Also,
by the 2008 Income Tax Amendment actually become effective, Article 55, paragraph 1 of the Income Tax Act was amended again on December 31, 2009\(^1\) so that sub-paragraph 2 lowering the income tax rate for the highest bracket would only apply to the income accrued on or after January 1, 2012. Contrary to the expectation at the time of such amendment, hostile social atmosphere against tax reduction for high income individuals did not subside as time passed by. Coupled with such social atmosphere was the need to increase tax revenue due to increase in the gross national expenditure. What is more, presidential election was approaching\(^1\). On December 31, 2011, just before the once-deferred effective date for the income tax reduction, the National Assembly amended Article 55, paragraph 1 again in such a way that the contemplated tax reduction was actually repealed, and, what is more, a higher bracket of 38% was additionally created as shown in the table 1 below.

<Table 1: Income Tax Rates before and after 2011 Amendments>

<table>
<thead>
<tr>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to KW 12Mil</td>
<td>6%</td>
</tr>
<tr>
<td>Above KW12Mil-Up toKW46Mil</td>
<td>15%</td>
</tr>
<tr>
<td>Above KW46Mil-Up to KW88Mil</td>
<td>24%</td>
</tr>
<tr>
<td>Above KW88Mil</td>
<td>35%</td>
</tr>
<tr>
<td></td>
<td>Above KW300 Mil.</td>
</tr>
</tbody>
</table>

### IV. Interrupted Efforts to Reduce Corporate Income Tax

The applicable Corporate Income Tax Rate until 2008 was 13% for the lower bracket and 25% for the upper bracket. Considering the fact that the competing Asian countries such as Hong Kong, Singapore, and Taiwan were on the track of reducing corporate tax rates, the article 55 of the Corporate Income Tax Act of Korea was amended in December 2008 (“2008 Corporate Income Tax Act Amendment”)\(^1\) to lower the corporate tax rates in two phases. Phase 1 of the 2008 Corporate Income Tax Act Amendment consisted of lowering the

---

\(^{14}\) The Law Number 9898.

\(^{15}\) The presidential election for the Republic of Korea was on December 19, 2012.

\(^{16}\) The Corporate Tax Act amended on December 26, 2008 (the Law Number 9267).
applicable corporate tax rates from 13% to 11% for the lower bracket and from 25% to 22% for the upper bracket, for a business year starting during the period between January 1, 2009 and December 31, 2009. Phase 2 of the 2008 Corporate Income Tax Act Amendment, which would be applicable for a business year starting on or after January 1, 2010, contemplated of further reduction of corporate tax rates, the applicable rate being 10% for the lower bracket and 20% for the upper bracket respectively.

<table>
<thead>
<tr>
<th>&lt;Table 2: 2008 Corporate Tax Act Amendment&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>For Business Year starting during Jan 1, 2009 to Dec 31, 2009</td>
</tr>
<tr>
<td>Up to KW200 Mil.</td>
</tr>
<tr>
<td>Above KW200 Mil. – Up to KW20 Bn.</td>
</tr>
<tr>
<td>For Business Year starting on or after Jan 1, 2010</td>
</tr>
<tr>
<td>Up to KW200 Mil.</td>
</tr>
<tr>
<td>Above KW200 Mil. – Up to KW20 Bn.</td>
</tr>
</tbody>
</table>

Just like the 2008 Income Tax Act Amendment, the 2008 Corporate Tax Act Amendment was also challenged fiercely by the opposition party as a tax policy benefiting the conglomerates only. As a result, just before implementation of the Phase 2 of the 2008 Corporate Tax Act Amendment, the Corporate Tax Act was amended again on December 31, 200917 deferring the Phase 2 reduction for the upper bracket until January 1, 2012 so that only the Phase 2 reduction for the lower bracket would take effect from January 1, 2010.

<table>
<thead>
<tr>
<th>&lt;Table 3: December 2009 Amendment&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>For Business Year starting during Jan 1, 2010 to Dec 31, 2011</td>
</tr>
<tr>
<td>Up to KW200 Mil.</td>
</tr>
<tr>
<td>Above KW200 Mil</td>
</tr>
<tr>
<td>For Business Year starting on or after Jan 1, 2012</td>
</tr>
<tr>
<td>Up to KW200 Mil.</td>
</tr>
<tr>
<td>Above KW200 Mil.</td>
</tr>
</tbody>
</table>

By the end of 2011, partly due to emerging hostile social atmosphere against conglomerates more vividly above the surface and partly due to the growing concern for maintaining the nation's fiscal soundness, the voices for corporate income reduction rapidly began to lose ground. In the end, such change of circumstances added up to virtual abandonment of Phase 2

17 The Corporate Tax Act amended on December 31, 2009 (the Law Number 9898)
implementation. The National Assembly resolved on December 31, 2011 to implement the deferred tax reduction for the upper bracket only up to certain limited extent ("2011 Corporate Tax Act Amendment")\(^\text{18}\). Pursuant to 2011 Corporate Tax Act Amendment, the reduced rate 20% is applicable only to corporation with a tax base equal to or less than 20 Billion Korean Won and the 22% continues to apply to corporation with a tax base more than 20 Billion Korean Won.

\begin{table}[h]
\centering
\begin{tabular}{|c|c|}
\hline
Tax Base & Rate \\
\hline
Up to KW200 Million & 10\% \\
\hline
Above KW200 Million – Up to KW20 Billion & 20\% \\
\hline
Above KW20 Billion & 22\% \\
\hline
\end{tabular}
\caption{2011 Corporate Tax Act Amendment}
\end{table}

V. Recent Developments of the Gift Tax and Inheritance Tax Act (the “Gift Tax Act”)

Recent developments of the Gift Tax Act can be summarized as “No free transfer of wealth without tax”. In the past, the Gift Tax Act was interpreted to be based on a positive system so that a free transfer of any economic value will be subject to gift tax if it is made in the form and manner as specifically provided in the Gift Tax Act as a tax triggering event. However, since the introduction of the notion of the “comprehensive gift” into the Gift Tax Act in 2004, there have been attempts to impose gift tax on certain transactions eventually resulting in indirect transfer of some economic value based on the ground that such transfer of wealth constitutes “comprehensive gift” to the transferee despite the fact that such transactions do not fall within the scope of gift tax triggering events specifically provided in the Gift Tax Act. Moreover, the December 2011 Gift Tax Act Amendment introduced a new legislation to impose gift tax on the controlling shareholders of a company for profits of the company arising from the transactions with affiliated companies.

A. Notion of Comprehensive Gift

Before 2004, there was no doubt that the Gift Tax Act was under a positive system so that gift tax may be imposed only in the cases of economic value transfer without consideration in a manner as specifically provided in the Gift Tax Act. There is no doubt that the Gift Tax Act should capture, to the extent possible, any free transfer of economic value which,

---

\(^{18}\) The Corporate Tax Act was amended on December 31, 2011 (The Law Number 11128).
in the majority opinion of the society members, should be subject to gift tax. As the Gift Tax Act was under the positive system, it should be amended from time to time to add new types of free transfer which, in the reasonable opinion of the society, should be subject to gift tax but are not yet covered under the Gift Tax Act. In reality, however, it is not easy for a statute to reflect all the social and economic changes in time as these develop. Inevitably it allows room for various tax planning strategies to create free transfer of economic value in a manner not falling within the categories listed in the Gift Tax Act so as to avoid gift tax. Many people asserted that frequent occurrences of free transfer of wealth shrewdly manipulated to escape gift tax was one of the major factors aggravating polarization of wealth problem. Specifically, when a number of cases involving members of conglomerates transferring wealth to their children in a very sophisticated manner so as to evade the net of the Gift Tax Act surfaced to catch the attention of the public, voices demanding amendment of Gift Tax Act to capture such transfer of wealth gained more power.

Finally, in 2004, the Gift Tax Act introduced a completely expansive notion of “comprehensive gift” in article 2, paragraph 3 to expand the scope of “gift” very widely so as to capture any direct and indirect transfer of economic benefit under the definition of “gift” under the Gift Tax Act. Under article 2, paragraph 3 of the Gift Tax Act, “gift” is now defined as (i) any free transfer (including transfer at a remarkably cheap price) the tangible or intangible properties with calculable economic values to another person in a direct or an indirect method, notwithstanding the name, form, purpose etc. of the relevant acts or transactions, or (ii) any increase in one’s property values arising from other person’s contribution. Other than expanding the scope of “gift” so widely based on the notion of comprehensive gift, however, the current Gift Tax Act does not provide expressly whether any act falling within such wide definition of “gift” under article 2, paragraph 3 automatically becomes subject to gift tax or whether more detailed provisions need to be expressly provided in the Gift Tax Act to actually impose gift tax. What is more, the Gift Tax Act is silent regarding to what extent indirect transfer is to be actually captured as a gift and how the tax base will be calculated in such case. Thus, to what extent any indirect transfer of wealth without consideration may be captured under the Gift Tax Act is very

For example, in 1996, Samsung–Everland issued convertible bonds at a very low price to a few people including the son of Mr. Kunhee Lee, the chairman of Samsung Group. The son exercised the conversion rights of the convertible bonds to become the largest shareholder of Samsung–Everland, which effectively controls the companies within the Samsung Group. As acquisition of convertible bonds at a low price was not listed in the Gift Tax Act at that time as a triggering event, no gift tax was paid.
unclear at the moment. Such ambiguity arose hot debate as to the actual function of the article 2, paragraph 3 of the Gift Tax Act in the context of imposing gift tax. The Constitution of Korea adopts the principle of no taxation without law by expressly providing that ‘all citizens shall have the duty to pay taxes under the conditions as prescribed by an Act.’\(^{20}\) Derived from this principle of no taxation without law, one of the firmly established principle of Korean tax laws is “the clarity of tax laws”, i.e. tax laws should be clear as to the object of taxation as well as how that tax amount is to be calculated. Thus, it is argued that it will be directly violating “the clarity of tax laws” principle if gift tax is to be imposed solely based on the definition of the “gift” in article 2, paragraph 3 of the Gift Tax Act.

Although it is still controversial as to whether it is possible to actually impose gift tax based solely on the definition of “gift” provided in article 2 paragraph 3, the Korean tax authorities recently expressed positive view on this issue. Specifically, the National Tax Service took a position that the introduction of “comprehensive gift” notion in the Gift Tax Act prepared sufficient theoretical grounds for imposing gift tax upon any direct or indirect economic benefits received by a person even if such transfer is not specifically listed in the Gift Tax Act as being subject to gift tax, and actually imposed gift tax based on this Article 2, Paragraph 3 of the Gift Tax Act in 2011 in a number of cases.

In one case, the tax authorities actually decided to impose gift tax imposed on the controlling shareholders of a company for increased share value where the value of such company’s share was increased due to a gift made to such company by a company specially related to the relevant controlling shareholder. In this case Father owned 100% of shares issued by a certain company (“Company A”) and his two sons own 100% shares in another company (“Company B”). Father donated the shares of Company A to Company B so that Company A became a 100% subsidiary of Company B. For the increased assets value of Company B, Company B paid corporate income tax. Still the tax authorities imposed gift tax to Sons for the increased value of the shares of Company B held by two sons. The court of first instance upheld the decision of the tax authorities\(^{21}\) and this case is at the appellate court at the moment. There are a number of similar cases pending at Korean courts. Tax payers are arguing that the current Gift Tax Act lacks specific details required to actually impose gift tax such as (i) specific provisions drawing borderlines for indirect economic interest which are subject to gift tax, (ii) timing of gift and calculation method for such gift, etc., and that unless such provisions are expressly provided in the law, gift tax should not be

---

\(^{20}\) Article 38 of the Constitution of Korea.

\(^{21}\) Seoul Administration Court case, with the case number 2011kuhap42543.
imposed solely based on the notions of “comprehensive gift”.

B. Gift Tax on Deliberate Work Placements between Affiliated Parties: Establishment of a New Article 45-3 in the Gift Tax Act

The article 45-3 of Gift Tax Act related to deliberate work placements between affiliated parties was first introduced into the Gift Tax Act in 2011. The purpose of this article is to prevent a controlling shareholder’s family actually passing over the family wealth to the next generation through the used of business relationships with affiliated companies aimed at increasing the value of the shares of such affiliated company. What often happens is, the controlling shareholder influences the companies under his control to provide most, if not all, of the business opportunities to the company owned by his or her children or his relatives (“the beneficiary entity”) so that the business of the beneficiary entity can easily become prosperous without facing much business risk. As the business grows, the controlling shareholders (i.e. children or relatives) will benefit for the increased share value of the beneficiary entity, however, as there is no physical transfer of wealth, it was difficult to impose gift tax on the controlling shareholders of the beneficiary entity for such economic benefit. Hence, article 45-3 under the heading of ‘Deemed Gift on the Income Earned from Related Party Transactions’ was newly introduced into the Gift Tax Act for imposition of a gift tax on such deliberate work placement between related parties.

Under article 45-3 of the Gift Tax Act, in the event the “Affiliated Transaction Ratio” of a company (“the Beneficiary Company”) exceeds the “Normal Rate”, then certain economic benefit calculated in the manner prescribed in article 45-3 shall be deemed to be transferred to the Controlling Shareholder of the Beneficiary Company and the relatives of the Controlling Shareholder holding more than 3% of the shares of the beneficiary Company. The economic benefit so deemed transferred subject to gift tax by these shareholders. The Affiliated Transaction Ratio is defined as the ratio of the sales volume deriving from the Beneficiary Company’s transactions with the companies affiliated with the controlling shareholders of the Beneficiary Company over the total sales volume of the Beneficiary Company. The Normal Rate is currently set at 30%. The Controlling Shareholder shall mean the person meeting the requirements set forth in the Enforcement Decree to the Gift Tax Act, which in most cases, refers to the largest shareholder of the Beneficiary Company.

---

22 Gift Tax Act amendment on December 31, 2011 (the law number 11130)
24 Article 34-2, paragraph 4 of the Enforcement Decree to the Gift Tax Act
Pursuant to article 45-3, paragraph 1 of the Gift Tax Act, the tax base for the relevant shareholder shall be calculated pursuant the following formula:

\[
\text{Tax Base} = (\text{post-tax profit of the beneficiary entity}) \times (\text{ratio of transactions with corporations in the same business group} - \text{half of the Normal Rate}) \times (\text{the taxpayer’s shareholding ratio in the beneficiary entity} - 3\%)\]

Recently, there are discussions as to whether deliberate work placements among affiliate companies that took place before introduction of this article 45-3 may still trigger gift tax solely based on the notion of the comprehensive gift under article 2, paragraph 3 of the Gift Tax Act. Article 3 of the Addendum to the revised Gift Tax Act amended in 2011 as of December 31, 2011 provides that this new article 45-3 shall be applicable to any related party transactions occurring on or after the first day of the fiscal year starting after January 1, 2012. Thus, inferring from the provisions of such Addendum, it was common understanding that the deliberate work placement which already took place before January 1, 2012 would not be subject to gift tax. However, the Board of Audit and Inspection of Korea (“BAI”) pointed out in its recent audit report that despite 9 years have passed since the introduction of the concept of “comprehensive gift”, taxation on the deliberate work placement among related parties has not been done properly. The mentioning of the ‘comprehensive gift’ by the BAI as a legal ground to impose gift tax on economic benefits transferred through the deliberate work placement between related parties is stirring up lots of speculations as to the taxable period(s) for which the authorities will levy gift taxes in connection with the deliberate work placement. Until the recent announcement of BAI’s official position on deliberate work placements, it had been the general understanding that gift tax may be imposed on deliberate work placement between related parties only based on a specific provision authorizing such imposition and that is why article 45-3 was inserted to the Gift Tax Act. The view of the BAI seems to be contrary to actual scope that is to be captured under the definition of ‘gift’ in article 2, paragraph

---

25 Amended in January 2013. Originally, it was as follows:

\[
\text{Tax Base} = (\text{post-tax profit of the beneficiary entity}) \times (\text{ratio of transactions with corporations in the same business group} - \text{the Normal Rate}) \times (\text{the taxpayer’s shareholding ratio in the beneficiary entity} - 3\%)
\]

26 Addendum to Gift Tax Act amended on December 31, 2011 with the law number 11130.

27 The Board of Audit and Inspection of Korea Audit Report, ‘Actual Conditions of Taxation on the Change in Shares and Capital Transaction’, issued on April 10, 2013

28 BAI is taking the position that article 45-3 alone constitutes sufficient legal grounds to impose gift tax and the specific provisions in the Gift Tax Act describing in detail the tax triggering events under the Gift Tax Act are only examples to provide a guideline as to actual scope that is to be captured under the definition of ‘gift’ in article 2, paragraph
to such general understanding. Given the foregoing and also considering the current emphasis on the so-called “Economic Democratization” policy in Korea, there is a possibility that the National Tax Service may attempt to impose a gift tax, even for the deliberate work placement between related parties occurred before the year 2011. Consequently, it makes sense to pay close attention to the future development of the issue.

C. Gift tax for non-residents

Previously, if a donee was a non-resident of Korea, gift tax was imposed only in the event the assets were located in Korea.29 The article 2, paragraph 1, subparagraph 2 of the Gift Tax Act was amended in 201330 to expand the scope of assets subject to gift tax by non-resident donee to include certain assets located outside Korea. Under article 2, paragraph 1, subparagraph 2 of the Gift Tax Act as amended, the scope of the foreign assets subject to gift tax by a non-resident done is to be specified in the Enforcement Decree of the Gift Tax Act. The purpose of the amendment is to capture the evasion of the gift tax by actually transforming the local assets into foreign assets through various legal tools, such as using foreign accounts or a company established outside Korea. Currently, the foreign assets subject to gift tax by non-residents include foreign financial accounts as well as shares in foreign company if such foreign company has 50% or more of its total assets located in Korea as of the date such donation is made.31 This amendment is applicable for the gifts received on or after the effective date of the Presidential Decree (February 15, 2013).

VI. Contemplated Efforts to Expand the Financial Transactions Tax to Derivative Transactions

A. Existing Financial Transactions Tax- a Robin Hood Tax32?

29 Article 2, paragraph 1, sub-paragraph 2 of the Gift Tax Act before the amendment in 2013.
30 Gift Tax Act Amendment as of January 1, 2013, with the law number 11609.
31 Article 2, paragraph 3 of the Gift Tax Act Enforcement Decree.
32 Financial Transaction Tax is often referred to as a Robin Hood Tax. According to the Wikipedia, the Robin Hood tax is defined as follows: ‘The Robin Hood tax commonly refers to a package of financial transaction taxes, proposed by a campaigning group of civil society NGOs. … A UK based global campaign for the Robin Hood tax was launched on 10 February 2010 and is being run by a coalition of over 50 charities and organizations, including Christian Aid, Comic Relief and UNICEF. ….. The campaign (U.S.: lobbying effort) has proposed to set taxes on a range of financial transactions – the rate would vary but would average at about 0.05%.'
While the movement to introduce so-called Robin Hood tax referring to a package of financial transactions taxes (“FTT”) may be a quite new movement in the Eurozone and U.S.A.\(^{33}\), the UK global campaign for the Robin Hood tax being launched on 10 February 2010,\(^{34}\) a FTT for trade in stocks has been existing in Korea since 1962 under the name of the securities transaction tax (“STT”).\(^{35}\) While the idea of Robin Hood Tax currently gaining popularity in Eurozone and U.S.A is based on the motivation to force banks and financial institutions to pay for the 2008 financial crisis\(^{36}\), STT was introduced into Korea back in 1963 for a different reason. In Korea, except in case of stocks held by a certain large shareholder holding stocks in excess of a threshold specified in the Income Tax Act, income tax is not imposed on capital gains made from trade in stocks through the Korea Exchange or the KOSDAQ. This was to promote the Korean capital market in its early stage. Instead, STT was imposed on the seller of the stocks in proportion of the transaction amount. For stocks traded in the Korea Exchange and KOSDAQ, STT is withheld by the securities company from the purchase price received by the seller. Thus, the function of STT is, to a certain extent, to supplement the tax revenue that is reduced due to exemption on capital gains, and also to enable easy collection of tax through withholding mechanism. As STT is limited to trade in stocks, financial transaction tax is not imposed on derivative transactions at the moment.

The tax would be applied to those trading in financial products such as stocks, bonds, currencies, commodities, futures, and options.’

\(^{33}\) The slogan for the Robin Hood Tax campaign is “turning a global crisis into a global opportunity”. According to Robin Hood Tax proponents, it is “a tax on banks that would give billions to tackle poverty and climate change, here and abroad” and “Robin Hood Taxes would take from the richest in society and give to those who need it”. See the website of THEROBINHOODTAX at [http://robinhoodtax.org.uk](http://robinhoodtax.org.uk), accessed July 15, 2013.

\(^{34}\) The idea of a financial transaction tax goes back to John Maynard Keynes. In his General Theory of Employment Interest and Money, he argued for a securities transaction tax asserting that is would reduce financial speculation. The idea was revived in the wake of the financial crisis, for example, Paul Krugman urged a financial transaction cost in order to curb the activities of speculators and financial “hyper activity”. See John Carney, “The Robin Hood Tax Won’t Work”, CMBC.com on 7 Dec 2011, available at [http://www.cnbc.com/id/45583134](http://www.cnbc.com/id/45583134), accessed July 15, 2013.

\(^{35}\) Securities Transaction Tax Act was enacted in Korea on November 28, 1962, (the law number 1189) which became effective from January 1, 1963. The tax rate at that time was 0.1 ~0.2% of the transaction amount depending on the settlement method. Currently it is 0.15% for the stocks traded in the Korea Exchange and 0.3% for the stocks trade at KOSDAQ and 0.5% for stocks traded otherwise.

\(^{36}\) See John Carney, note 31 [supra].
B. Current Status of Introducing a Transaction Tax on Derivative Transactions

In August 2012, the Ministry of Strategy and Finance (“MOSF”), in an effort to expand the scope of the current financial transaction tax to include certain derivative transactions, submitted a tax bill (“2012 Tax Bill”) to the National Assembly proposing that a transaction tax should be imposed on certain derivative transactions dealing with certain designated derivatives products indexed to stock prices. According to 2012 Tax Bill, a 3-year grace period\(^\text{37}\) was to be provided. The 2012 Tax Bill targeted the Korea Exchange traded derivative products where the price index of stocks is the underlying assets; the applicable tax rate for KOSPI 200 futures is 0.001% of the notional amount, and the applicable tax rate for KOSPI 200 options is 0.01% of the transaction price. However, due to the strong opposition by the financial industry\(^\text{38}\), 2012 Tax Bill did not pass the National Assembly in 2012.

However, in its business report to the President on April 3, 2013, MOSF made it clear that it has decided to push ahead with the enactment of transaction tax on derivative transactions once more\(^\text{39}\). The contents of transaction tax on derivative transactions being re-introduced by the government are same as that of the original proposal submitted to the National Assembly in 2012. As expected, the market is fiercely opposing against the MOSF’s efforts to re-introduce the transaction tax on derivative transactions.\(^\text{40}\) What is more, it seems that there are different views even among within the government as to whether it is desirable to introduce transaction tax on derivative transactions.\(^\text{41}\) The tax bill submitted by MOSF to the National Assembly this year to

\(^{37}\) MOSF explained that the 3-year grace period was necessary to minimize the effect on the market, including a possible downturn in number of trades, and also to secure a period of time for preparation for the enforcement.

\(^{38}\) For example, the Korea Exchange has prepared a report titled “The Ripple Effects of ETF Tax and Derivative Tax on the Market” in 2012 in an attempt to persuade the members of the National Assembly. The Korea Financial Investment Association has also disclosed their opposing position, stating that the imposition of transaction tax on derivatives would severely shrink the derivatives market.

\(^{39}\) See the newspaper article of The Korea Daily Economics on April 4, 2013.

\(^{40}\) See the newspaper article of MTN on April 8, 2013.

\(^{41}\) For example, on May 6, 2013, Mr. Je-Yoon Shin, the Chairman of the Financial Services Commission, while speaking as a keynote speaker at the “2013 IOMA and the WFE Derivatives Conference” held in Busan, Korea, expressed his views against the introduction of the transaction tax on derivative transactions. See the newspaper article of The Korea Economic Daily on May 6, 2013. Also, Mr. Jung-hoon Kim, a member of the National Assembly belonging to the ruling party, while speaking at a “Regular Seminar of the Korea Derivatives Finance Forum” held on April 3, 2013 in
amend the Securities Transaction Tax to introduce the transaction tax on derivative transactions is currently under the review of the Tax Sub-committee of the Strategy and Finance Committee of the National Assembly, however, prospects for a swift resolution on the matter remains rather dim.

C. Pros and Cons of Transaction Tax on Derivative Transactions

MOSF seems to believe that imposing a transaction tax on derivative transactions is a good way to raise tax revenues as well as to reduce financial speculation in the Korean derivative market. Further, considering the fact that a securities transaction tax are being imposed on trades in stocks at the moment, it conforms with the principle of fairness. MOSF projects the tax revenue increase to be more than 100 billion won per year if a transaction tax on derivative transactions is imposed according the tax bill submitted.\(^{42}\) The Korea Institute of Public Finance ("KIPF"), a government-operated research institute, issued a report\(^ {43}\) arguing for a transaction tax on derivative transactions. Based on the analysis of various economic and financial indices, the KIPF report concludes that as the speculative activities in the Korean derivative market is far more active than in the financial markets of other countries, at least for the interim period until income tax is imposed on capital gains from financial transactions, it is desirable that a transaction tax is imposed on derivative transactions.\(^ {44}\)

But the financial industry is fiercely opposing the re-introduction again. They are asserting that the imposition of tax on derivative transactions could result in the disappearance of derivative transactions that have been subsiding substantially from last year. The Korea Capital Market Institute ("KCMI"), a premier capital market research institute in Korea supports the position of the financial industry. In the seminar held by KCMI in Seoul on September 6, 2012\(^ {45}\), Mr. Gil-Nam Nam of KCMI

---

\(^{42}\) The newspaper article of The Financial Times on April 4, 2013
\(^{44}\) Ibid at p.159.
asserted that imposing transaction tax on derivative transaction at the rate proposed by the MOSF will increase the transaction cost by at least 20% so that the trade volume in terms of the transaction amount will decrease by 22% in case of futures and 12% in case of options. Hence, the aggregate tax revenue for transactions tax for stocks and derivatives may decrease by 110 Billion Korean Won, and even in the most optimistic case where the aggregate tax revenue increases, the amount of increase will not exceed 20 Billion Korean Won. The National Assembly Budget Office (“NABO”) agrees with KCMI in a sense that the transactions tax on derivative transactions will reduce the trade volume of the derivative transactions to a certain extent, however, NABO disagrees that the overall tax revenue related to financial transactions tax will decrease. On the contrary, NABO predicts the tax revenue increase during 2013-2017 to be 659 Billion Korean Won for futures and 267.3 Billion Korean Won for options assuming that the applicable tax rate for futures is 0.001% and for options is 0.01% despite the decrease in the trade volume of derivative transactions. So the development of the situation is being watched with keen interest.

VII. Outlook and Conclusion

Although many amendments towards increasing tax revenue are already in place, the opposition parties are still demanding a more radical increase of tax for wealthy individuals and the large companies to generate more tax revenue to be used to increase social welfare benefits to ordinary people and fight poverty across the country. For example, in July 2012, some members of the Jinbo Justice Party, a relatively more radical progressive party, submitted a tax bill to the National Assembly to increase the current highest corporate income tax rate to 30%. Another tax bill proposing to increase the current

---

46 See the KCMI press release, note 45 supra.
47 Eun-Dong Chae, “A Study on the Introduction of Transaction Taxes on Derivative Financial Products”, National Assembly Budget Office, August 2012 at p.37–p.45. According to this report, the trade volume of options during the years of 2013–2017 will be decreased by 9.6%–9.8% in terms of the transaction amount and by 13.7%–13.9% in terms of the number of transactions, assuming that the applicable tax rate is 0.01%. For futures, the trade volume during the years of 2013–2017 will be decreased by 12.6%–13.0% in terms of the transaction amount and by 13.3%–13.4% in terms of the number of transactions.
48 Ibid at p.41
49 Ibid at p.43
50 The Bill No. 1900437, Mr. Won-Suk Park of the Jinbo Justice Party being the representative member of National Assembly submitting the bill. This bill is currently pending at the Strategy and Finance Committee of the National Assembly. The proposed revision is summarized in the table below.
highest corporate income tax rate to 25% was submitted to the National Assembly by the members of the Democratic Party, a less radical progressive party in September 2012.\footnote{The Bill No. 1901685, Mr. Nak-Yeon Lee of the Democratic Party being the representative member of National Assembly submitting the bill. The suggested tax rates are summarized in the table below:}

Since expansion of social welfare was one of the centerpiece of President Park Geun-hye’s campaign in 2012\footnote{As a matter of fact, the campaign promises of all the presidential candidates were by and large heading towards offering more “social welfare” benefits in 2012 presidential election. Thus, whoever would win the election, increase of social welfare benefit was an accomplished fact.}, hot debates as to whether the social welfare plan promised during the campaign should actually be maintained, and if so, how should it be funded, started right even before President Park’s inauguration and are still going on. Although President Park made it clear that she would pursue the original social welfare plan without tax increase\footnote{Her campaign pledge for increase of social welfare was based on funding 2.7 trillion Korean per year through restructuring the government expenditure and not through tax increase. Moreover, on May 31, 2013, President Park announced a so-called “Official Pledges Account Book” providing more detailed plans of how the 140 national tasks, which were selected by Park’s government as the target tasks to implement Park’s campaign pledges, are to be funded. According to the Official Pledges Account Book, the total of 134.8 trillion Korean Won will be needed to implement 140 national tasks and 50.7 trillion Korean Won will be funded by increase tax revenue ensured through means such as bringing out into the open sources of underground economy money or abolishing tax exemptions and reductions etc. and the remaining 84.1 trillion will be funded by cutting back the government expenditure reducing waste to a minimum. Details of the Welfare Account Book is available at the Blue House blog at http://blog.president.go.kr/10169444337, accessed July 15, 2013.}, there have been on-going debates as to whether implementation of President Park’s welfare plan is actually possible without tax increase\footnote{At a seminar held on May 23, 2013, co-sponsored by the Korea Economic Research Institute (“KERI”) and the Association of Korea Economic Studies under the theme of “The Welfare Plan of the New Government: Is it possible without tax increase?”, Mr. Kyoung-yup Cho, a speaker from KERI asserted that the welfare budget for the coming 5 years would reach 153 trillion Korean Won, a sum far greater than the amount}. Recently,  

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
\textbf{Tax Base} & \textbf{Current Rate} & \textbf{New Rate} \\
\hline
Up to KW200 Million & 10\% & 10\% \\
Above KW200 Million – Up to KW20 Billion & 20\% & 20\% \\
Above KW20 Billion–Up to KW100 Billion & 22\% & 22\% \\
Above KW100 Billion & & 30\% \\
\hline
\end{tabular}
\end{table}
the National Assembly Budget Office ("NABO") reported that the tax revenue as of April in 2013 is 9.3 Trillion Korean Won less than that of April in 2012 and called for measures to ensure tax revenue to the appropriate level so as to maintain nation’s fiscal soundness.\textsuperscript{55} NABO’s report indicated that the main reason for such decrease in tax revenue is due to the decreased collection of the corporate tax income arising from applying the reduced corporate tax rate (20%) to tier 2 group of companies. Under these circumstances, debates on the necessity of tax increase are being heated up. On the other hand there are also voices expressing concerns as to the negative impacts on the economy such tax increase would bring about. Specifically, the Federation of Korean Industries ("FKI")\textsuperscript{56}, in its recent report\textsuperscript{57}, warned that current anti-business environments and anti-business measures, including tax increase based on the anti-business sentiment, will eventually lead to a gradual exodus of Korean companies to abroad. If the large domestic companies actually start moving their business center and/or production base outside Korea, it would have a significant negative impact on the Korean economy and in the long run, it will be ordinary workers who are most hurt. That would be the last thing anybody would like to see. The differences of current positions on tax increase issue arise from the different approaches taken as to whether the conglomerates and wealthy individuals would, eventually accept, though reluctantly, to bear some more taxes than now. Provided that tax increase on them is kept within the limit they can endure, increasing tax would be the right measure to ensure ongoing funding for social welfare programmes far into the future. If it goes beyond that limit, it may have the most undesired effect, minimizing economic growth and provoking major job losses when everybody agrees that the priority now is to create jobs. At the moment, Korean economy is slumping and, what is worse, there are fears in the market that the Korean economy may languish into a long-term depression like Japan. Against this background, so far the Korean government has been showing a very cautious attitude as to the tax increase issue, especially those taxes directly affecting business. It remains to be seen which path Korea will eventually take in the long run, however, considering the current economic recession, it will, at least, take some time to raise the corporate income tax rate above

---

\textsuperscript{55} See the press news of the Joseilbo, July 9, 2013

\textsuperscript{56} FKI is a multifunctional association for domestic industries, consisting of Korea’s major conglomerates and associated members.

\textsuperscript{57} “Seven Symptoms Indicating Exodus of Korean Economy”, 『CEO-Memo』, FKI, June 2013. According to this report, seven social symptoms that would lead to gradual exodus of Korean companies to abroad are as follows: demand for tax increase contrary to international standard, excessive regulations on business, difficulty in making adjustments for supply cost, continuing phenomenon of weak yen, high production factors cost, gridlock in management-union relations and growing anti-business sentiments.
the current applicable rate, if that ever happens at all.