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OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	Korea's Foreign Investment Zone regime (KR001) – Final description and assessment

ROLLBACK REVIEW PROCESS (JANUARY 2019)

In July 2018, the Code of Conduct Group agreed to accept Korea's request to extend the grandfathering mechanisms until 2034 in view of the potential litigation risks that Korea could face and given the fact that the potential number of companies to benefit from this extended period is likely to be very low. To keep track of the developments, Korea has been invited to report to the Group on an annual basis statistics relating to the use of the regime. In December 2018, Korea has amended the legislation regulating the its Free investment zone (FIZ) preferential tax regime identified as harmful in 2017.

Law 16009 amended par. 2 and 12 of art 121-2 of the Special Tax Treatment Control Law, in which the preferential tax treatment for companies benefitting from the regimes was established. The amendments introduce a cut-off date for companies in order to apply to the regime. Companies cannot benefit from the regime if their application is submitted after 31 December 2018. On this basis, it can be concluded that the amendments are equivalent to the abolition of the regime from 1 January 2019.

The Code of Conduct Group meeting of 30 January 2019 approved the rollback of the regime. This conclusion was endorsed by the ECOFIN Council on 12 March 2019.

Annex 1: Assessment of the old KR001 regime in 2017 (standstill review)

Annex 2: informal English translation of the final legislation

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ANNEX 1

Assessment of the old KR001 regime in 2017 (standstill)

a. Description

A foreign investment zone (FIZ) is designated to facilitate foreign investment, and provides various investment incentives for moving-in companies in the zone. It is categorized into complex-type, individual-type, R&D-type, and service-type, which vary in terms of the designation requirements, occupancy requirements and limitations and investment incentives. For complex-type, industrial-type and R&D type, "*two or more investors can move into the zones, but it is allowed only to foreign companies.*"

For foreign investments, taxes, such as corporate tax, income tax, acquisition tax, registration tax, property tax and aggregate land tax, may be abated or exempted under conditions as prescribed by the Restriction of Special Taxation Act. "The corporate tax or income tax on dividends derived from stocks or equities acquired by a foreign investor […] shall be reduced or exempted in proportion to a percentage of the gross income for each taxable year of the foreign-capital invested company concerned which is represented by income derived from its operation of the business eligible for reduction of or exemption from corporate tax or income tax under paragraph (1); however, for a period for which the total tax amount subject to reduction of or exemption from corporate tax or income tax is exempted under paragraph (2), he shall be allowed an exemption from the total tax amount, and for a period for which a tax amount equivalent to 50/100 of the tax amount subject to reduction of or exemption from corporate tax or income tax is reduced under paragraph (2), he shall be allowed a reduction of a tax amount equivalent to 50/100".

b. Preferential features/ Benefits available under the Foreign investment zone regime

Domestic corporations are subject to corporation tax of progressive rates, 10%, 20% or 22%. Foreign investors in such zones benefit of the following tax exemptions or reductions:

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Tax Reductions or Exemptions	National tax	Corporate tax / income tax	7 yrs. 100%/5 yrs. & 50%/2 yrs.
	Local tax[1]	Acquisition tax / property tax	7 yrs. 100%/5 yrs. & 50%/2 yrs.

Therefore, a preferential treatment is applied to foreign companies operating in FIZ.

c. Possible concerns/What is the problem under the Code?

A regime limited to foreign tax payers[2] and/or to operations outside the territory of the jurisdiction (ring fenced regime) does not meet criteria 1 & 2 of the Code of Conduct which prohibit this type of ring fencing. Foreign investment zone regime is targeted to foreign enterprises or for activities with foreign entities/markets since tax advantages are granted only to foreign enterprises or in respect of transactions carried out with non-residents (for example for complex-type, industrial-type and R&D type zones).

Another important Code criterion used to assess the harmfulness of a regime is its transparency (criterion 5). A measure is considered as not transparent when it is not laid down in law but granted on a discretionary basis. Thus, a regime which provides for tax measures that lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way risks in violating criterion 5 of the Code. In some situations, local governments can grant longer reductions or exemptions periods (up to 15 years) and this by ordinance, thus such incentives are left at the discretion of the local administrations.

[1] Some local governments grant longer reduction or exemptions periods up to 15 years by their ordinance.

[2] The risk of ring-fencing is evident, as it is specifically mentioned that the regime is allowed only to foreign companies.

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Source of information

Korean Tourism Organization

Assessment by the FHTP: Out of Scope.

d. Assessment:

	1a	1b	2a	2b	3	4	5
Korea – Foreign Investment Zone (FIZ) (KR001)	**V**	**V**	**V**	**V**	**V**	**X**	**V**

V = harmful

X = not harmful

Explanation

Gateway criterion - Significantly lower level of taxation:

"Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code"

Domestic corporations are subject to corporation tax of progressive rates up to 22%. Foreign investors in Foreign Investment Zones benefit from 100% exemption of corporate tax for up to 5 years and a 50% exemption for a further 2 years. There is a similarly scaled exemption for local acquisition and property taxes - Article 121-2 and 121-3 of the Restriction of Special Taxation Act and Article 116-2 of the Enforcement Decree of the Restriction of Special Taxation Act refer.

The measure therefore provides for a significant lower level of taxation and is potentially harmful under the Code

Criterion 1 – Targeting non-residents:

"whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents"

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a concerns the de jure application of the measure.

1b) Criterion 1b is used to complement the assessment under criterion 1a which only looks at the literal interpretation of the measure. It takes account of the de facto effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b.

The measure is de lege available only to non-residents.

Criterion 2 – Ring-fencing:

"*whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base*"

As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. de jure interpretation and de facto analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

2a) What has been written under criterion 1a often applies analogously to criterion 2a.

2b) On the basis of the explanations provided above and the marking under criterion 1b, the evaluation of criterion 2b often follows the same reasoning.

Criterion 3 - Substance:

"*whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages*"

According to the standard practice for the evaluation of a measure against criterion 3, a measure is found harmful under this criterion if there are no specific requirements with regard to real economic activities and notably any requirement with respect to employment obligations.

The legislation appears to make no special requirements with regard to either economic activities or employment obligations.

Criterion 4 – Internationally accepted principles:

"*whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD*"

The measure does not appear to contradict any internationally embraced principle.

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Criterion 5 - Transparency:

"***whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way***"

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent.

Considerable discretion appears to be given to local governments who can grant longer reductions or exemptions periods (up to 15 years) for local property, acquisition etc. taxes. Article 121-2(4) of the Restriction of Special Taxation Act refers.

Overall assessment

"***Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community***"

In the light of the assessment made under all Code criteria, the regime is considered as overall harmful.

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ANNEX 2

Informal English translation of the final legislation

No. 19406 Official Gazette Monday, 24 December 2018

Amendment to the Special Tax Treatment Control Law which was approved in the National Assembly is hereby promulgated.

President Moon Jae-in /Signed/

24 December 2018

Prime Minister Lee Nak-yun

State Council Member, Minister of Economy and Finance Hong Nam-ki

O Law No. 16009

Amendment to the Special Tax Treatment Control Law

Part of the Special Tax Treatment Control Law is amended as follows.

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Title of Article 121-2 “Reduction or Exemption of Corporate Tax, etc for Foreign Investment” shall be changed into “Tax Reduction or Exemption for Foreign Investment” , and the initial part of Paragraph 2 of the same Article other than the subparagraphs shall be changed as follows, while “Foreign-capital Invested Enterprises” of Paragraph 12(1) shall be changed into “Foreign-capital Invested Enterprises that have filed an application for Tax Reduction or Exemption by 31 December 2018 under Paragraph 6”.

: A Foreign Invested Enterprise that has filed an application under Paragraph 6 by 31 December 2018 shall be eligible for a reduction of, or exemption from tax, as follows, on the income accruing from a business eligible for tax reductions or exemptions under Paragraph 1 (or the income prescribed by Presidential Decree in cases of any business eligible for tax reductions or exemptions under Paragraph 1(1).

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Addedum

Article 1(Implementation Date) This law shall be implemented from 1 January 2019. However, the amendment to Article 121-2 shall be implemented on the date of promulgation.

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