PRESS RELEASE

ASIFMA Cites Concerns on Korea’s Capital Gains Tax Changes for Foreigners

Significant change poses extremely challenging operational hurdles for securities companies and for the overall Korean market infrastructure with little or no additional tax revenue

8 January 2018, Hong Kong – The Korean Ministry of Strategy and Finance (MOSF) just issued draft regulations reducing the shareholding ownership threshold at which capital gains tax (CGT) will be triggered for foreign investors from 25% to 5% on listed securities transactions. It is proposed to take effect from July 1, 2018. This follows on from an earlier announcement by the MOSF on August 2, 2017 whereby they initially publicized their intent to lower the threshold at which the CGT will be imposed on shares traded on the Korea Exchange.

ASIFMA had expressed concerns on the earlier proposal and continues to be deeply concerned with the current development. Currently, if a foreign investor and its related parties collectively hold less than 25% of a company, capital gains are exempt from tax. The proposed change means that CGT is triggered when the foreign investor and its related parties collectively hold 5% or more of the company at the time of the sale or at any point in time over the past five years. The CGT is the lower of 22% of the capital gains or 11% of the sales proceeds.

This is a significant change that poses extremely challenging operational hurdles for securities companies and for the overall Korean market infrastructure for little or no additional tax revenue for the Korean Government. Securities companies have the obligation to deduct and remit CGT (if any) to the Korean Government. By law they are required to be withholding agents, and if they fail to comply with this obligation, they have liability for the uncollected CGT plus penalties (i.e., they have secondary tax liability).

For securities companies to comply with this obligation, they will need to (i) determine the collective ownership percentage of the foreign investor and its related parties at the time of sale and over the past five years, and (ii) determine the acquisition price of the shares being sold. Under the current market infrastructure system in Korea, however, there is no mechanism for securities companies to obtain such information. Thus, they are not able to determine whether CGT is due nor how much, yet will be exposed to significant unknown tax liability as a withholding agent. To avoid being exposed to the secondary tax liability, securities companies may treat everything as a gain and deduct 11% of the total sales proceeds, which will burden the foreign investor to directly seek a refund from the Korean Government. A 11% withholding on all sales proceeds will have a significant detrimental impact to foreign investors and a disastrous consequence for the Korean equities market.

ASIFMA cautions that the CGT concerns transactions of listed shares on the Korea Exchange where the average daily equity trading volume was USD 3.4 billion in 2017, with a high of USD 8.6 billion and settlement is done on a T+2 cycle. Foreign investors can and do trade across multiple securities companies. A robust common market infrastructure system needs to be developed to provide in a timely
manner the requisite information for securities companies to comply with their obligations. The overwhelming majority of foreign investors hold less than 5% of the shares of a Korean company. As a result, little, if any, actual tax revenue will be raised by this measure, whilst requiring substantial investment in technology and process to enable compliance and causing major disruptions.

If the MOSF wishes to proceed with the lowering of the threshold, ASIFMA recommends that they provide a mechanism for securities companies to practically comply with their withholding obligation. Investment should be made to develop market infrastructure (e.g., at Korea Exchange or another platform) to track ownership percentages and weighted average acquisition costs to provide such information on a real time basis to securities companies. This type of market infrastructure project takes considerable time to develop, and implementation should be delayed until it is ready. The MOSF is inviting public comment on the draft regulation until January 29. We strongly advise they take into account the operational hurdles and current market infrastructure limitations before proceeding.

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About ASIFMA

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