The Journal of Small Business Innovation 2017 20(1), pp. 1-18

Does Tax Really Matter in Planning the Dongbu Group's Spin-Offs?

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This study examined whether divided and spun-off companies design and execute spin-offs to minimize tax burdens by analyzing multiple spin-off transactions in the Dongbu Group, when the Korean tax law regarding corporate restructuring was amended in July 2010.

Before the July 2010 tax amendment, taxes on the capital gains arising from the qualifying spin-off were deferred to the earlier of the shares in or assets acquired by the spun-off company are disposed. This tax treatment relieves the divided company's tax burden by deferring taxes on capital gains, compared with non-qualifying spin-offs. However, if shares in or assets acquired by the spun-off company are disposed after the July 2010 tax amendment, the capital gain incurred at the time of the qualifying spin-off would be taxed again at the spun-off company, in addition to a taxation on the divided company's capital gains. This creates double taxation implications for the parties involved in the spin-off. As a result, the double taxation may outweigh the benefit from the tax deferral on the qualifying spin-off, which may make a qualifying spin-off tax unfavorable.

Among the four spin-off cases in the Dongbu Group addressed in this study, a spin-off occurred before the tax amendment, whereas three spin-offs occurred after the tax amendment. Initially, we expected that the spin-off before the tax amendment would be a qualifying spin-off, and the other three spin-offs would be non-qualifying spin-offs, considering the taxation rules before and after the July 2010 tax amendment. However, based on the review of summarized balance sheets disclosed in the spin-offs' corporate filings, no capital gains arose during the four spin-offs that occurred in the Dongbu Group. Therefore, we concluded that the Dongbu Group considered non-tax factors more than tax factors while designing and executing the spin-offs. The local media posited during this period that these spin-offs may intend to resolve financial issues in the Dongbu Group, and this analysis was supported by the fact that some shares in the new spun-off companies were sold by the Dongbu Group.

Our case studies provide evidence that all costs, including both tax and non-tax costs, must be considered in the course of spin-offs, in addition to the tax burdens on all parties involved in the corporate restructuring, which parallels the work of Scholes et al. (2008). This study provides implications that various aspects should be considered and reviewed in advance when the management makes decisions for effective tax planning.

Keywords *: Spin-off, Tax deferral, Tax planning*

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Ⅰ. Introduction

The Dongbu Group frequently established multiple corporations by spinning off existing internal business units during the six-month period from June 2010 to January 2011. For example, Dongbu Hannong was established on June 3, 2010, as a spin-off from Dongbu HiTek's agricultural business department. Dongbu Chemical, which used to be the biotechnology business unit in Dongbu, Inc., was established as a spin-off from Dongbu, Inc., on August 4, 2010, before merging into Dongbu Hannong on October 1, 2010. Additionally, Dongbu Express was incorporated as a spin-off from the transportation and logistics business unit in Dongbu Construction on January 3, 2011. Further, Dongbu Steel established its subsidiary, Dongbu Specialty Steel, by spinning off its wire rod business unit on January 5, 2011. This series of business spin-offs was announced by Dongbu Group as part of the conglomerate's business restructuring to achieve globalization, specialization, and high value-added business as stepping stones to establish a holding company.[1] However, the restructuring was perceived as intended to externally resolve financial issues. In addition to these non-tax aspects, given that three out of the four spin-offs occurred after January 2010 when the tax regulation for business restructuring was amended, the possibility exists that the Dongbu Group might have strategically adjusted the timing of the spin-offs to exploit the tax regulations in the amendment. Specifically, tax was expected to be a primary factor in pursuing a spin-off, as the spin-off generally does not incur non-tax costs, such as conflicts of interests that could occur in a split or merger.

This case study analyzed the Dongbu Group's spin-offs from a tax planning perspective to investigate whether the restructurings were intended to utilize relaxed tax regulations. Specifically, our study investigated whether the four spin-offs, which occurred in the Dongbu Group under the tax regulation around the amendment in July 2010, enjoyed tax benefits as a result of its restructuring. As tax planning for spin-offs affects the tax positions of both the new spun-off and a divided company (i.e., the new spun-off company's parent company) in the course of the spin-off, this tax planning should consider all contracting parties' interests. Therefore, this case study could be a useful case for anyone attempting to understand the spin-off in terms of tax planning.

As the Korean tax law provides SME including venture firms with additional various tax benefits such as deferral of capital gain tax from transfer of shares in SME in the course of the corporate restructure, this study should demonstrate references from a tax perspective for SME which may pursue M&A in the future. In particular, since this study addresses the four spin-offs which took place around the tax amendment, this research takes good business cases to examine whether and how a tax factor affects the corporate restructuring decision.

This case study was organized as follows: First, the second chapter introduces amended tax regulations for restructuring by a comparison with the prior regulations, before the July 2010 amendment. The third chapter analyzes the Dongbu Group's four spin-offs in detail by referencing these tax regulations to confirm whether a tax factor impacts decisions made in the business' restructuring. Finally, the fourth chapter summarizes the Dongbu Group's spin-off cases.

Ⅱ. Regulatory Background

2.1 Introduction to Spin-Offs

A spin-off is a demerging structure, which separates a company's business division into a new entity as a company subsidiary. In the course of the spin-off, the existing divided company transfers owned business assets to a new spun-off company and then receives

1) Korean Daily Business (Oct 12, 2010)-Consecutive corporate restructuring in Dongbu Group. Why?

shares in the new spun-off company in return. Therefore the divided company becomes a 100% parent of the spun-off company as a result of the spin-off. As the spun-off company newly emerged is 100% owned by the existing divided company, the spin-off is sometimes called as vertical divestiture in practice (Chemmanaur and An, 2004; Chemmanaur et al., 2014).

Spin-offs were not allowed until the mid-1990s under the former Korean Commercial Law. However, the spin-off was introduced in late 1998 after an amendment to the Korean Commercial Law in the wake of the Asian financial crisis, when corporate restructuring was requested for various reasons. Additionally, under the Monopoly Regulation and Fair Trade Act (MRFTA) amended in January 1999, a holding company's establishment through spin-off was accepted if the company reported this establishment to the appropriate regulatory body (i.e., the Fair Trade Commission) in accordance with the MRFTA presidential decree (Choi, 2009; Jeong, 2009; Lee, 2007; Son, 2004).

2.2 Amendment to the Korean Taxation Rule for the Spin-off

Article 530-12 of the 1998 amended Korean Commercial Law notes that the amended rule is applicable only when a divided company acquires 100% shares in a new company, to be newly established in the course of the spin-off. Figure 1 below illustrates the tax implications arising from the spin-off.

Business divisions transferred to the new company during the spin-off comprehensively include business assets, employees, and liabilities. This type of corporate restructuring differs from the business transfer, which may selectively transfer various assets. As Figure 1 presents, the built-in gains in the transferred business division's assets and liabilities is to be realized during the spin-off at the time of transfer; hence, the gain may be treated as taxable(Cho, 2006; Jin, 2008). However, as the business division merely shifts its position to the new company, which was a part of the divided company before the spin-off, the taxation rule may prevent corporate restructuring if the capital gain aris-

Figure 1
Tax Implication of Spin-off

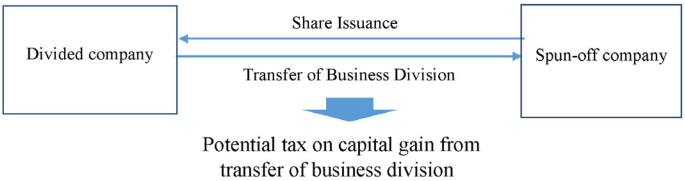
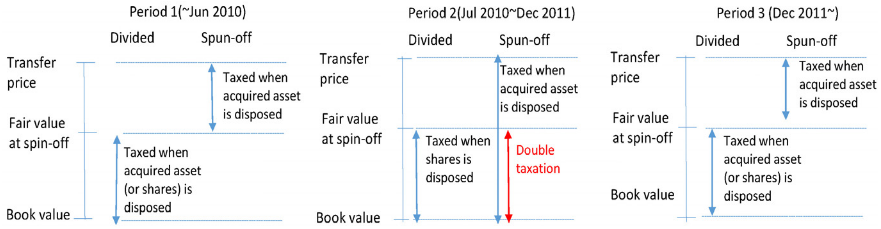


Table 1
Requirements of the Qualifying Spin-off*

- The divided company must be a domestic company which has been in business for at least five years prior to the spin-off registration date;
- The spun-off company must be a business unit which is capable of carrying on its business wholly on its own, and the assets and liabilities of the divided business unit must be comprehensively transferred to the spun-off company; and
- The spun-off company continues to operate the business unit transferred from the divided corporation until the end of fiscal year which includes the spin-off registration date ("Business Continuity")
- 100% of the consideration received by the divided company must be in shares of the new spun-off company and the shares must be owned until the end of the fiscal year which includes the spin-off registration date ("Ownership Continuity")

* Article 46(2) of the Corporate Income Tax Law ("CITL").

Figure 2
Amendments to the Tax Deferral Rule on Capital Gain from the Qualifying Spin-off



ing from the spin-off is taxable. Thus, Korean corporate income tax facilitates corporate restructuring through the spin-off process by allowing a tax deferral on capital gains, to the extent that a spin-off meets the designated requirements, as summarized in Table 1 ("Qualifying Spin-offs"). The tax deferred via the qualifying spin-off is assessed when the tax deferral retention requirements are breached (i.e., the spun-off company's shares or assets are disposed.)

Meanwhile, the tax deferral rule for capital gains from the qualifying spin-off has been amended twice since the rule became effective in 1998. Figure 2 explains how the tax deferral rules have provided tax benefits in three respective periods (Period 1: before June 2010, Period 2: July 2010 to 2011, and Period 3: post-2011), which are classified based on the rule's two amendments.

Figure 2 notes that the tax deferral rule for the qualifying spin-off in Period 1 is the same as the rule in Period 3. The tax on capital gains for those periods earned by the divided company, which equals the fair value minus the book value of assets, is deferred by the recognition of allowances for the capital gains at the time of spin-off. The capital gains are then taxed by reversing the allowance, either when the divided company transfers shares in the spun-off company, or when the spun-off company disposes of its assets acquired.[2] The fair value of acquired assets during the spin-off is deemed as acquisition costs for the spun-off company.[3] Further, the capital gains from transferring thes pun-off company's assets to a third party is determined by the transfer price minus the fair value of the assets acquired at the time of spin-off. If an asset acquired by the spun-off company is depreciable, the spun-off company may save taxes by increasing the depreciation expense from the asset's basis, increased to fair value.[4]

Meanwhile, the tax on capital gains earned by the divided company in Period 2 is also deferred, with a deferral allowance, and gains are taxed only when shares in the spun-off company are transferred, as with the tax treatments in Periods 1 and 3. However, the new spun-off company's book value of acquired assets during the spin-off is deemed to be an acquisition cost[5]; the capital gains, based on the book value (or the transfer price minus the book value), are taxed when the new spun-off company transfers the acquired asset. In such a case, the divided company's capital gains may be double-taxed if the spun-off company disposes of the acquired asset. Additionally, if the acquired asset is depreciable, the spun-off company cannot enjoy the tax benefit provided by

2) Article 46-3(3) of the CITL.

3) Article 82-4(1) of the presidential decree of the CITL.

4) This study assumed that fair market value is generally higher than book value.

5) Article 82-4(1) of the presidential decree of the CITL effective in June 2010; Korean Ministry of Strategy and Finance Press Release (May 3, 2010)-Amendments to Korean tax laws.

the increase in basis due to the catch-up on the capital gains, which departs from tax treatments in Periods 1 and 3.

2.3 Tax-Saving Effects from the Qualifying Spin-Off: Comparison of Tax Treatments in Periods 1 and 2

Figures 3 and 4 reflect all contractual spin-off parties' perspectives as suggested by Scholes et al. (2008) by illustrating the tax-saving effects from the deferral of taxes on capital gains derived from the qualifying spin-off during either Periods 1 or 2. Assets acquired by the spun-off company are assumed to be non-depreciable and depreciable, respectively. "G" refers to the capital gains (i.e., the fair value minus the book value at the spin-off) arising from the spin-off.

Regarding the tax effects on non-depreciable assets as presented in Figure 3, the tax on the capital gains arising from the qualifying spin-off is deferred to the earlier of the shares in, or assets acquired, by the spun-off company, and are disposed in Period 1. This tax treatment relieves the divided company's tax burden by deferring taxes on capital gains, compared with non-qualifying spin-offs.

Figure 3
Scenario where Acquired Asset is a Non-Depreciable Asset

Period	Type of spin-off	Entity	Timing	
			Spin off	Subsequent transfer of asset (or shares)
Period 1	Non qualifying spin-off	Divided	Tax on G	×
		Spun-off	×	×
	Qualifying spin-off	Divided	×	Tax on G
		Spun-off	×	×
Period 2	Non qualifying spin-off	Divided	Tax on G	×
		Spun-off	×	×
	Qualifying spin-off	Divided	×	Tax on G
		Spun-off	×	Tax on G

* Where
Divided: divided company
Spun-off: Spun-off company
G: Capital gain arising from spin-off (fair value less book value)
X: No tax on the capital gain

Figure 4
Scenario where Acquired Asset is a Depreciable Asset

Period	Type of spin-off	Entity	Timing	
			Spin off	Subsequent transfer of asset (or shares)
Period 1	Non qualifying spin-off	Divided	Tax on G	×
		Spun-off	×	×
	Qualifying spin-off	Divided	×	Tax on G
		Spun-off	×	×
Period 2	Non qualifying spin-off	Divided	Tax on G	×
		Spun-off	×	×
	Qualifying spin-off	Divided	×	Tax on G
		Spun-off	×	Tax on G

* Where
Divided: divided company
Spun-off: Spun-off company
G: Capital gain arising from spin-off (fair value less book value)
X: No tax on the capital gain

However, the same amount of capital gains would be taxed again for the spun-off company if the acquired asset is disposed in Period 2, in addition to taxation of the divided company's capital gains, which produces double-taxation implications. Thus, the double taxation may outweigh the deferred tax benefits from the qualifying spin-off.

Figure 4 illustrates the case of the qualifying spin-off, in which tax on the capital gains derived from a spin-off is deferred until the divided company disposes its shares in the spun-off company. Additionally, even in the qualifying spin-off's case, the spun-off company may reduce its tax burden by deducting a greater depreciation expense from the basis increase from the spin-off.

However, this tax benefit for the qualifying spin-off decreases in Period 2, as Figure 2 describes. Although higher depreciation expenses can be deducted and capital gains taxes can be deferred in the qualifying spin-off in Period 2, the capital gains incurred during the spin-off are taxed for not only the divided company, but also the spun-off company when the former disposes of its shares in the latter and the latter disposes its assets.[6] Given that only the divided company's capital gains are taxed in the case of non-qualifying spin-offs, a non-qualifying spin-off may be advantageous over the qualifying spin-off in Period 2 from certain tax perspectives.

Ⅲ. Analysis of the spin-off cases

Table 2 classifies the Dongbu Group's spin-off cases to be analyzed in this study, by the tax benefit rules applicable in Periods 1 and 2.

Regarding Case 1 (divided company: Dongbu HiTek; spun-off company: Dongbu Hannong), the spin-off date was June 3, 2010, or less than a month before the enforcement of the amended tax rule in Period 2. If tax factors were considered more than non-tax factors, the spin-off may be a qualifying spin-off since the spin-off should be subject to the unfavorable tax rule in Period 2 if the spin-off had been delayed to July 1, 2010 or after. This particular spin-off was expected to be timed deliberately for tax purposes. However, if the spin-off was treated as non-qualifying, the Dongbu Group would then more likely consider non-tax factors. Our study will later investigate whether this spin-off is considered as qualifying.

Meanwhile, regarding Cases 2, 3, and 4, it is less certain whether these spin-offs were tax driven compared to Case 1, as qualifying spin-offs during Period 2 are not necessarily advantageous over non-qualifying spin-offs, from a tax perspective. As the spin-off date (August 4, 2010) in Case 2 (divided company: Dongbu, Inc.; spun-off company: Dongbu Chemical) was a month from the tax rule enforcement date in Period 2 (July 1, 2010), it was anticipated that the spin-off would deliberately occur in Period 2, versus Period 1. The spin-off was estimated as non-qualifying, as the Dongbu Group should have accelerated the spin-off's timing before Period 2 to exploit the greater tax benefit in Period 1 if the spin-off had been qualifying. This would further consider that a qualifying spin-off in Period 2 would not have been as tax-favorable as in Period 1.

Regarding Cases 3 and 4, the Dongbu Group would not consider the tax rule for qualifying spin-offs in Period 1, as the spin-offs occurred more than six months from the tax rule, which expired July 1, 2010. Thus, this study analyzed these cases without a particular prediction of whether the spin-offs are qualifying, as the qualifying spin-off did not always provide a smaller tax burden during Period 2.

3.1 Case 1 (Divided Company: Dongbu HiTek; Spun-Off Company: Dongbu Hannong)

In the qualifying spin-off's case, the deferred tax liability (or asset) increases (or

6) Compared to the analysis in Figure 3, no implications of double taxation were found on G in Figure 4.

Table 2
Spin-off Cases of Dongbu Group

Case No	Divided Company	Spun-off Company	Spin-off date	Period
1	Dongbu HiTek	Dongbu Hannong	June 3, 2010	Period 1
2	Dongbu Inc	Dongbu Chemical Co. Ltd	August 4, 2010	
3	Dongbu Construction	Dongbu Express	January 3, 2011	Period 2
4	Dongbu Steel	Dongbu Specialty Steel	January 5, 2011	

Table 3
Summarized Balance Sheets before and after Spin-off (Case 1)

(Unit: KRW mil)

	Prior to Spin -off (ⓐ)	Post Spin-off		Increase (ⓑ+ⓒ - ⓐ)
		Dongbu Hannong (Spun-off) (ⓑ)	Dongbu Hitek (Divided) (ⓒ)	
Total Asset	2,477,486	809,074	1,977,524	309,113
Total Liabilities	1,874,496	499,961	1,374,535	0
Capital, Capital surplus ("Capital")	886,712	309,113	886,712	309,113
Other Equity	-283,722	0	-283,722	0
Total Equity	602,989	309,113	602,989	309,113
Total Liabilities and Equity	2,477,486	809,074	1,977,524	309,113

decreases) in the divided company's financial statements due to the allowance for capital gains derived from the spin-off. The financial statement's footnotes were reviewed to determine whether the spin-off in Case 1 was qualifying, and based on this review, the journal entries related to deferred tax liabilities can be summarized as follows:

(Unit: KRW mil)

Tax refundable	2,815
Tax expense	13,157
Deferred tax liability	13,036
Deferred tax liability (ⓐ)	15,101
Deferred tax asset (ⓐ)	13,907

As the footnotes from Dongbu HiTek's financial statements only disclosed the total ending balance of the allowance for capital gains, we further reviewed the summarized balance sheet in the corporate restructuring report publicly disclosed immediately after the spin-off, which assists us in picking up the allowance for capital gains derived from the spin-off in Case 1. The spin-off parties' financial positions can be summarized in Table 3:

Meanwhile, the journal entries to be made by Dongbu HiTek and Dongbu Hannong at the time of the spin-off can be presented as follows:[7]

Divided company (Dongbu HiTek):		
Investment in Equity		MV
	Business Asset	BV
	Capital Gain	MV–BV
New Spun-off company (Dongbu Hannong):		
Business Asset	MV	
	Capital	MV

Where
MV: Fair market value of business net asset in business department spun off
BV: Book value of business net asset in business department spun off.

By considering Table 3 and the above journal entries, the KRW 309 billion increase in assets can be decomposed into (MV-BV) (divided company) and MV (spun-off company). Further, based on the spun-off company's capital as provided in Table 3, the MV, which equals the newly contributed cap-

7) As no change occurred in the amount of liabilities in the course of the spin-off, liabilities are ignored in the journal entries presented.

ital from the divided company, amounts to KRW 309 billion. Therefore, the BV also amounted to KRW 309 billion, as (2MV -BV) equals this amount.

It was discovered based on the above analysis that no difference existed between the book value and fair value of assets in the business division spun off from Dongbu HiTek. This suggests that this spin-off did not arise from any situation in which the capital gains must be considered during corporate restructuring, and that there were no tax-saving effects (i.e., tax deferrals), even if the spin-off qualifies for a tax deferral.

Given that no capital gains were incurred in the course of the spin-off, it is likely that non-tax factors were considered more than tax factors when the Dongbu Group planned this spin-off. The primary non-tax factor seems to be the financial issues the Dongbu Group faced, as mentioned in the Introduction. This is supported by subsequent events, in that Dongbu HiTek (the divided company) transferred approximately 76% of shares in Dongbu Hannong (the spun-off company) to financial investors on December 27, 2010, and the remaining shares were transferred to Dongbu, Inc., and its related parties.

Additionally, although the spin-off in Case 1 was treated as qualifying at the time of the event, the spin-off should become non-qualifying later, as it breached the last requirement in Table 1 ("Ownership Continuity") when the divided company sold its shares in the spun-off company. Nevertheless, as no capital gains were incurred at the time of the spin-off, there should be no additional tax burden on the divided company when it transferred the shares subsequent to the spin-off.

3.2 Case 2 (Divided Company: Dongbu, Inc.; Spun-Off Company: Dongbu Chemical)

We confirm whether the spin-off in Case 2 is non-qualifying by reviewing the notes in the divided company's 2010 financial statements (Dongbu, Inc.), as well as the journal entries made by the company relative to its deferred taxes, which can be summarized as follows:

Tax expense	4,440
Deferred tax liabilities	1,777
Tax payable	352
Deferred tax asset (ⓐ)	5,865

Our review of the footnotes reveals that the decrease in deferred tax assets of KRW 5.865 billion was directly charged to equity. In this regard, as the decrease does not relate to the allowance for capital gains, we estimated that this spin-off did not qualify for tax deferral benefits under the rule in Period 2.

As aforementioned, a non-qualifying spin-off may be more tax favorable to a taxpayer than a qualifying spin-off during Period 2. This is possible in circumstances where the tax to be paid by a divided company in a non-qualifying spin-off is less than the present value of total taxes deferred for both the divided and spun-off companies in a qualifying spin-off. We analyzed whether this was as such in Case 2.

A weighted average borrowing rate of 6.09% is assumed to be an appropriate discount rate for the analysis, based on the 2010 financial statements from Dongbu, Inc.[8] It is also assumed that Dongbu Inc. (the divided company) would hold shares in Dongbu Chemical(the spun-off company) for 10years. If a non-qualifying spin-off is tax-advantageous over a qualifying spin-off under these assumptions, a present value factor to discount the future tax to be paid by Dongbu Chemical over 10 years should be greater than 0.4462. As the present value factor for the tax to be paid by Dongbu,Inc., is 0.5538 (i.e., $1 \div (1+6.09\%)^{10}$), a present value factor for Dongbu Chemical should be greater than 0.4462 (i.e., 1-0.5538) for a

8) The weighted average borrowing rate is based on the financial statements for Dongbu, Inc., in 2010.

(Unit: KRW billion)

Liabilities (Opening)	Liabilities (Ending)	Interest Expense	Weighted average borrowing rate
258	376	19	6.09%

non-qualifying spin-off to be more tax-favorable than a qualifying spin-off. Thus, Dongbu Chemical should meet the following conditions:

$$\frac{1}{(1+r)^n} > 0.4462$$
$$(1+r)^n > 2.2414$$

where
r = Dongbu Chemical's discount rate; and
n = Dongbu Chemical's acquired asset holding period.

Given that Dongbu Chemical merged with Dongbu Hannong in October 2010, only two months from the spin-off, n in the above formula is 0.16 (or 2/12). With n of 0.16 in the formula, the discount rate is determined as less than 12,580%, which is true in any case. Even if a change is made to the assumed period of shares held by Dongbu, Inc., the calculated discount rates range in Table 4, which is true in any case. These results can be interpreted as the taxes that Dongbu, Inc., should immediately pay are not likely to be greater than the present value of the total taxes deferred for both divided company and spun-off company, and thus, a qualifying spin-off in Case 2 was unlikely to be tax-favorable.

We augment the above analysis by reviewing and analyzing the summarized balance sheet disclosed by Dongbu, Inc., as presented in Table 5. The increase in business assets during the spin-off amounted to KRW 1.098 billion, which equals the spun-off company's increase in capital. Similar to our analysis

Table 4
Sensitivity Analysis on Discount Rate for Dongbu Chemical (Spun-off company) to Hold a Non-Qualifying Spin-off Tax Favorable

(Unit: KRW mil)

Share holding period for Dongbu Inc	Present value factor for Dongbu Chemical	$(1+r)^{2/12}$	Discount rate for Dongbu Chemical given n is 0.16 (=2/12)	Note
1	PVF > 5.74%	$(1+r)^n < 17.4293$	r < 2803387445%	
2	PVF > 11.15%	$(1+r)^n < 8.9720$	r < 52161239%	
5	PVF > 25.58%	$(1+r)^n < 3.9095$	r < 356929%	
10	PVF > 44.62%	$(1+r)^n < 2.2414$	r < 12580%	Discussed in the text
15	PVF > 58.78%	$(1+r)^n < 1.7012$	r < 2324%	
20	PVF > 69.33%	$(1+r)^n < 1.4425$	r < 801%	
30	PVF > 83.01%	$(1+r)^n < 1.2047$	r < 206%	
40	PVF > 90.59%	$(1+r)^n < 1.1039$	r < 81%	
50	PVF > 94.79%	$(1+r)^n < 1.0550$	r < 38%	

Table 5
Summarized Balance Sheets before and after Spin-off (Case 2)

(Unit: KRW mil)

	Prior to Spin -off (ⓐ)	Post Spin-off		Increase (ⓑ+ⓒ-ⓐ)
		Dongbu Hannong (Spun-off) (ⓑ)	Dongbu Hitek (Divided) (ⓒ)	
Total Asset	4,735	1,499	4,344	1,098
Total Liabilities	3,034	401	2,633	0
Capital, Capital surplus ("Capital")	482	1,098	482	1,098
Other Equity	1,219	0	1,219	0
Total Equity	1,701	1,098	1,701	1,098
Total Liabilities and Equity	4,735	1,499	4,334	1,098

conducted in Case 1, the increase in assets can be explained as (2MV-BV), and the spun-off company's increase in capital is equal to MV. Based on these relationships, no difference exists between the MV and BV of the business assets transferred during the spin-off. This finding suggests that no capital gains were incurred at the time of the spin-off; thus, the mitigation of the tax burden from the spin-off was irrelevant in Case 2. This implies that the spin-off in Case 2 may focus on such non-tax factors as the improvement of financial status, rather than tax factors.

3.3 Cases 3 (Divided Company: Dongbu Construction; Spun-Off Company: Dongbu Express) and 4 (Divided Company: Dongbu Steel; Spun-Off Company: Dongbu Specialty Steel)

As aforementioned, the spin-offs in Cases 3 and 4 occurred more than six months after the enforcement of the tax rule in Period 2; the spin-offs were thus presumed as planned by the Dongbu Group, with no consideration of the tax benefit rule in Period 1. Therefore, we reviewed and analyzed how efficiently they were organized under the rule in Period 2.

3.3.1 Case 3 (Divided Company: Dongbu Construction; Spun-Off Company: Dongbu Express)

Our review of the footnotes to the 2011 financial statements reveals that the balance of the temporary difference relating to the allowance for capital gains increased from zero to KRW 146 billion; however, this increase does not relate to the capital gains derived from the spin-off. This finding suggests that the spin-off in Case 3 may be non-qualifying.

If a non-qualifying spin-off is more tax efficient than a qualifying spin-off in Period 2, the total of the present value of the taxes deferred at the divided and spun-off company levels is greater than the tax to be paid by the divided company at the time of the spin-off. Thus, if a non-qualifying spin-off is more tax-favorable, the total of present value factors for the divided and spun-off companies should be greater than one. In this regard, the present value factor for Dongbu Express was expected to be greater than 0.3238[9] if a non-qualifying spin-off was more tax-favorable in January 2011, assuming that the weighted average borrowing rate for Dongbu Construction(the divided company) was 3.99%[10], and that shares in Dongbu Express are held by Dongbu Construction for 10 years.

Assuming that the weighted average borrowing rate is 7.58% for Dongbu Express[11] under these conditions, the business asset-holding period for Dongbu Express should be less than 15.44 years to have a more tax-efficient non-qualifying spin-off.[12] This holding period condition was relatively feasible; hence, a non-qualifying spin-off could be more efficient in this case. The same result would occur even the holding period for the shares owned by Dongbu Construction was modified.[13]

However, based on a review of the summarized balance sheet disclosed by Dongbu Construction, an increase in business assets

9) As the present value factor for Dongbu Construction is 0.6762 ($1/(1+3.99\%)^{10}$), a present value factor for Dongbu Express must be greater than 0.3238(1-0.6762).

10) The weighted average borrowing rate is based on Dongbu Construction's 2011 financial statements.

(Unit: KRW billion)

Liabilities (Opening)	Liabilities (Ending)	Interest Expense	Weighted average borrowing rate
1,470.5	1,709.3	63.4	3.99%

11) The weighted average borrowing rate is based on Dongbu Group's 2011 financial statements.

Liabilities (Opening)	Liabilities (Ending)	Interest Expense	Weighted average borrowing rate
0	483.6	18.3	7.58%

12) $1/(1+7.58\%)^n > 0.3238$; $N < 15.44$.

13) Sensitivity analysis on the asset-holding period for Dongbu Express (spun-off company) to hold a non-qualifying spin-off as more tax favorable.

(2MV-BV) of KRW 329.7 billion at the time of the spin-off equaled to the capital increase in Dongbu Express (MV). Therefore, no difference was found in the book value and fair market value of the assets in the business division spun off from Dongbu Construction. This further produced no capital gains at the time of the spin-off. This may be interpreted as the tax consideration to avoid a tax burden from the spin-off was not necessary in this case.

As there was no purpose in attempting to save tax on capital gains from the spin-off, this spin-off was not likely to be affected by tax factors. Rather, this spin-off was likely to be driven by non-tax factors, including the resolution of the Dongbu Group's financial troubles.

3.3.2 Case 4 (Divided Company: Dongbu Steel; Spun-Off Company: Dongbu Specialty Steel)

As with the prior cases' analyses, we first reviewed and analyzed the footnotes of Dongbu Steel's financial statements, and based on this review, no increase in deferred tax liabilities was found relating to allowances for capital gains derived from the spin-off in 2011. Thus, we expected that the spin-off in Case 4 was non-qualifying.

Therefore, if a non-qualifying spin-off was more tax favorable than a qualifying spin-off, the total present value factors for the deferred taxes on capital gains for both Dongbu Steel (the divided company) and Dongbu Specialty Steel (the spun-off company) should be greater than one, as with the prior cases' analyses. Given that the divided company's weighted average borrowing rate is 5.43%,[14] the present value factor for Dongbu Specialty Steel should be greater than 0.4107 if a non-qualifying spin-off is more tax efficient, assuming the holding period of shares owned by Dongbu Steel is 10 years.

The holding period of assets owned by the spun-off company under these conditions is less than 22.75 years to make a non-qualifying spin-off tax-favorable, given that the weighted average borrowing rate is 3.99%.[15] The asset holding period requirement was feasible from the spun-off company's perspective. Even i f modifications are made to the 10-year shareholding period, a non-qualifying spin-off could be more tax-efficient than a qualifying spin-off.[16]

We augment the above analysis by review-

Share holding period for Dongbu Construction	Present value factor for Dongbu Express	$(1+r)^n$	Asset holding period for Dongbu Express given r is 7.58%
1	PVF > 3.84%	$(1+r)^n < 26.05$	n < 44.64
2	PVF > 7.53%	$(1+r)^n < 13.28$	n < 35.41
5	PVF > 17.77%	$(1+r)^n < 5.62$	n < 23.65
10	PVF > 32.39%	$(1+r)^n < 3.08$	n < 15.44
15	PVF > 44.41%	$(1+r)^n < 2.25$	n < 11.12
20	PVF > 54.29%	$(1+r)^n < 1.84$	n < 8.36
30	PVF > 69.09%	$(1+r)^n < 1.44$	n < 5.06
40	PVF > 79.10%	$(1+r)^n < 1.26$	n < 3.21
50	PVF > 85.87%	$(1+r)^n < 1.16$	n < 2.09

14) The weighted average borrowing rate is based on the financial statements for Dongbu Steel in 2011.

(Unit: KRW billion)

Liabilities (Opening)	Liabilities (Ending)	Interest Expense	Weighted average borrowing rate
3,547.6	3,627.6	194.8	5.43%

15) The weighted average borrowing rate is based on Dongbu Specialty Steel's 2011 financial statements.

(Unit: KRW billion)

Liabilities (Opening)	Liabilities (Ending)	Interest Expense	Weighted average borrowing rate
0	188,5	3.7	3.99%

16) Sensitivity analysis on the asset-holding period for Dongbu Specialty Steel (spun-off company) to hold a non-qualifying spin-off as more tax favorable.

Share holding period for Dongbu Steel	Present value factor for Dongbu Specialty Steel	$(1+r)^n$	Asset holding period for Dongbu Specialty Steel given r is 3.99%
1	PVF > 5.15%	$(1+r)^n < 19.41$	n < 40.61
2	PVF > 10.04%	$(1+r)^n < 9.96$	n < 31.48
5	PVF > 23.24%	$(1+r)^n < 4.30$	n < 19.98
10	PVF > 41.08%	$(1+r)^n < 2.43$	n < 12.18
15	PVF > 54.77%	$(1+r)^n < 1.82$	n < 8.24
20	PVF > 65.28%	$(1+r)^n < 1.53$	n < 5.84
30	PVF > 79.54%	$(1+r)^n < 1.25$	n < 3.13
40	PVF > 87.95%	$(1+r)^n < 1.13$	n < 1.76
50	PVF > 92.90%	$(1+r)^n < 1.07$	n < 1.01

Table 6
Summarized Balance Sheets before and after Spin-off (Case 4)

(Unit: KRW mil)

	Prior to Spin-off (ⓐ)	Post Spin-off		Increase (ⓑ+ⓒ-ⓐ)
		Dongbu Hannong (Spun-off) (ⓑ)	Dongbu Hitek (Divided) (ⓒ)	
Total Asset	5,301,272	211,343	5,200,682	211,343
Total Liabilities	3,515,666	100,590	3,415,076	100,590
Capital, Capital surplus ("Capital")	1,785,606	110,753	1,785,606	110,753
Other Equity	811,638	110,753	811,638	110,753
Total Equity	973,968	0	973,968	0
Total Liabilities and Equity	1,785,606	110,753	1,785,606	110,753

ing and analyzing the summarized balance sheet disclosed by Dongbu Steel, as presented in Table 6. As indicated, the increase (2MV-BV) in net business assets during the spin-off amounted to KRW 110.8 million, which equals the spun-off company's increase in capital. As with prior cases, no difference was found between the fair market value and book value of the business assets transferred during the spin-off. This finding suggests that the tax factor did not need to be considered in the spin-off and that non-tax factors influenced the spin-off's decision-making in this case.

Ⅳ. Summary and conclusion

This case studies investigated whether the spin-offs that occurred in the Dongbu Group were designed and executed to minimize the tax burden on the parties (the divided and spun-off companies) when the spin-off taxation rule was amended on July 1, 2010.

The taxation rule before the July 1, 2010 amendment stated that if a spin-off was qualified to defer taxes on capital gains from the spin-off, the tax burden on the qualifying spin-off was highly likely to be less than the tax burden on a non-qualifying spin-off. However, it is uncertain after the amendment as to whether a qualifying spin-off was always more tax efficient than a non-qualifying spin-off, as taxes on capital gains from the spin-off were to be assessed for both the divided and spun-off companies in cases where conditions for the tax deferral under the amended law were breached (i.e., shares or assets in the spun-off company were disposed).

Among the Dongbu Group spin-offs addressed in this study, the spin-off in Case 1 occurred in Period 1 (before the tax deferral rule's amendment) and the other spin-offs occurred in Period 2 (after the tax deferral rule's amendment). As the tax benefit for the qualifying spin-off during Period 1 was more certain than the tax rule in Period 2, we initially posited that the spin-off in Case 1 was qualifying, whereas the other three spin-offs were non-qualifying. However, based on analyses of the summarized balance sheets disclosed at the time of spin-off, it was less likely that tax factors were considered in these spin-offs, as no capital gains were incurred in the course of the spin-off. These spin-offs, in other words, were not tax-driven corporate restructurings.

Therefore, given that no capital gains were to be tax-assessed during the spin-offs, it was anticipated that non-tax factors were considered more than tax factors when the spin-offs were designed and executed. In reality, the local media estimated that the spin-offs were driven to improve the Dongbu Group's financial status, and some of the shares in the spun-off company (Dongbu Hannong) were actually transferred after the spin-off, which supports that the spin-offs were not tax-motivated.

This study provides evidence that the perspectives of all parties involved in the corporate restructuring (the divided and spun-off companies) were considered throughout the course of the spin-offs and, regarding tax planning, such tax and non-tax factors as financial issues must be considered in restructuring. This study implies that various aspects should be considered and reviewed in advance when the management makes decisions for effective tax planning.

Received 29 Dec. 2016
Revised 06 Mar. 2017
Accepted 22 Mar. 2017

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<*Teaching Note*>

Does tax really matter in planning the Dongbu Group's Korean spin-offs?

Synopsis

This study investigated whether divided and spun-off companies may design and execute spin-offs to minimize tax burdens by analyzing multiple spin-off transactions made in the Dongbu Group when Korea's tax law for corporate restructuring was amended in July 2010.

Four spin-off transactions occurred within the Dongbu Group during the six-month period from June 2010 to January 2011, which from a practical perspective was perceived as unusually frequent corporate restructurings. The Dongbu Group announced this series of business divestitures as a part of the conglomerate's business restructuring to achieve globalization, specialization, and high value-added business as a stepping stone for the establishment of a holding company. However, the restructuring was also perceived as intended to externally resolve its financial issues.

Given that the Dongbu Group's series of spin-offs occurred around time the Korean tax law for corporate restructuring was amended, it was anticipated that the spin-offs were tax-motivated, to reduce the tax burden on capital gains derived from the spin-offs.

Tax on the capital gains arising from qualifying spin-offs prior to the July 2010 tax amendment was deferred to the timing earlier of the shares in or assets acquired by the spun-off company are disposed. This tax treatment relieves the divided company's tax burden by deferring taxes on capital gains, compared with non-qualifying spin-offs. However, if shares in or assets acquired by the spun-off company were disposed after the July 2010 tax amendment, the capital gains incurred at the time of the qualifying spin-off would be taxed again for the spun-off company, in addition to taxation of the divided company's capital gains, which produces double-taxation implications for the parties involved in the spin-off. Thus, the double taxation may outweigh the benefits from the tax deferral on the qualifying spin-off, which may make a qualifying spin-off tax-unfavorable.

Out of the Dongbu Group's four spin-off cases during this six-month period, a spin-off (divided company: Dongbu HiTek; spun-off company: Dongbu Hannong) occurred before the tax amendment, whereas three spin-offs occurred after the tax amendment. At this research's inception, we anticipated that the spin-off before the tax amendment would be qualifying, and the other three spin-offs would be non-qualifying, considering the taxation rules before and after the July 2010 tax amendment.

However, a review of summarized balance sheets disclosed in the spin-offs' corporate filings revealed that no capital gains arose from the Dongbu Group's four spin-offs.

Even when there were no tax-saving opportunities, the Dongbu Group pursued four spin-offs in a short period, of six months around the tax amendment. We anticipated that the Dongbu Group considered non-tax more than tax factors when designing and executing the spin-offs. The local media during this period posited that these spin-offs were intended to resolve the Dongbu Group's financial issues, and this analysis was supported by the fact that the Dongbu Group sold some shares in Dongbu Hannong, a new spun-off company.

Our case studies provide evidence that all costs, including both tax and non-tax costs, must be considered in the course of spin-offs, in addition to the tax burdens on all parties involved in the corporate restructuring, which is in line with the work of Scholes et al. (2008) work. This study provides implications that various aspects should be considered and reviewed in advance when the management makes decisions for effective tax planning.

Teaching Point

The following can be learned in studying these cases:

First, this case study presented how the Korean taxation rule on spin-offs changed in the course of the July 2010 Korean tax law amendment. Moreover, this case study presented a type of tax strategy that can be formulated and executed.

Second, this case study presented how the tax perspectives of all parties involved in a spin-off can be considered, in the context of the paradigm of Scholes et al. (2008). Additionally, this study demonstrated how all costs to be incurred in a spin-off can be analyzed based on corporate disclosures and circumstances around the spin-offs.

Third, this case study presented how optimized decisions can be made based on applicable information, and particularly in a situation where all tax and non-tax costs must be considered.

Assignment Questions

1. Discuss the difference between the Korean taxation rules for spin-off before and after the July 2010 amendment. Discuss what factors must be considered to minimize the tax burden for the companies involved in the spin-off.
2. Discuss how a qualifying spin-off is not necessarily advantageous over a non-qualifying spin-off, in terms of the tax around the July 2010 tax amendment.
3. Discuss any difference in relative tax saving effects on a qualifying spin-off, depending on whether the assets transferred during the spin-off are depreciable.
4. Discuss how to calculate the capital gains derived from the spin-off if balance sheets are provided in a corporate filing disclosed at the time of the spin-off.
5. Explain why the decision to pursue a spin-off is made, even when tax savings are not anticipated in a spin-off under the amended tax law.

Analysis

1. Discuss differences in the Korean taxation rules for spin-offs before and after the July 2010 amendment. Discuss what factors must be considered to minimize the tax burden for companies involved in the spin-off.

Qualifying spin-offs under Korean tax law before the July 2010 amendment should be more tax favorable than non-qualifying spin-offs by deferring taxes on capital gains earned by the spun-off company. However, the tax law after the amendment does not ascertain whether qualifying spin-offs are always more tax efficient than non-qualifying spin-offs due to the double taxation of both the divided and spun-off companies when tax deferral retention requirements are breached (i.e., when shares in or assets acquired by spun-off company are transferred). Therefore, if a spin-off is qualifying, a taxpayer was highly likely to execute the spin-off before the amendment to ensure a reduction of the tax burden on capital gains incurred from a tax perspective. If a spin-off is non-qualifying, it was better to pursue the spin-off after the amendment, as a non-qualifying spin-off may be more tax efficient than a qualifying spin-off in some cases.

2. Discuss whether a qualifying spin-off is necessarily advantageous over a non-qualifying spin-off in terms of tax around the July 2010 tax amendment.

A qualifying spin-off under Period 1 (i.e., before the July 2010 tax amendment) should be more tax favorable than a non-qualifying spin-off, as the tax on capital gains from the qualifying spin-off is deferred for a divided company until the tax deferral requirements are breached. However, the capital gains tax during Period 2 (i.e., after the July 2010 tax amendment) is assessed to both the divided and spun-off companies if the tax deferral requirements are breached. A qualifying spin-off is more tax favorable only if the present value of the sum of taxes to be paid by both the divided and spun-off companies is less than the tax to be paid outright by the divided company in a non-qualifying spin-off.

3. Discuss whether the assets transferred during a spin-off are depreciable, and if this makes any difference to the relative tax-saving effects of a qualifying spin-off.

Regarding non-depreciable assets, the tax on capital gains from spin-offs was assessed to the divided company alone during Period 1, regardless of whether the spin-off was eligible for tax deferral. If the spin-off is qualifying, the divided company defers its tax on capital gains until shares or assets in the spun-off company are disposed. Alternatively, when the divided and spun-off company dispose of shares held and assets acquired during Period 2, respectively subsequent to the qualifying spin-off, the capital gain taxes are assessed to both companies, which makes the qualifying spin-off tax-unfavorable.

As with the tax treatment of non-depreciable assets, the tax on capital gains of depreciable assets from the spin-off during Period 1 was assessed only to the divided company. As the basis of assets transferred during the spin-off increases to the fair market value for tax purposes, more depreciation expenses could be deducted for the spun-off company, regardless of whether the spin-off was eligible for tax deferral. If a spin-off during Period 1 is qualifying, the capital gains incurred at the spin-off could be deferred until the tax deferral retention requirements are breached (the assets or shares in the spun-off company are disposed), which makes the qualifying spin-off more tax efficient than a non-qualifying spin-off.

Alternatively, in the case of a qualifying spin-off during Period 2, the capital gains calculated based on the book value of depreciable assets could be taxed to the spun-off company if the tax deferral retention requirements are breached, which offset the tax-saving effects from the increased depreciation expense. However, in the case of a non-qualifying spin-off during Period 2, no assessment of capital gains tax was determined, based on the book value of depreciable assets in any case, subsequent to the spin-off. This may imply that a non-qualifying spin-off may be more tax advantageous over a qualifying spin-off in certain cases during Period 2.

Therefore, regardless of whether assets transferred during the spin-off are depreciable, a qualifying spin-off is more tax-efficient than a non-qualifying spin-off during Period 1. However, this situation in Period 2 depends on the circumstances.

4. Discuss how to calculate the capital gains derived from spin-off if balance sheets are provided in the corporate filings disclosed for the spin-off.

Where "BV" and "MV" refer to the book value and fair market value of assets transferred during the spin-off, respectively, the following respective journal entries would be made by the divided and spun-off companies:

<Divided Company>	
Equity (Spun-off Company)	MV
Business Asset	BV
Capital Gain	MV-BV
<Spun-off Company>	
Business Asset	MV
Capital	MV

Based on the above journal entries, an increase in the balance of total assets for both the divided and spun-off companies can be described as ((MV-BV) + MV) by comparing the two companies' balance sheets both before and after the spin-off. As MV can be easily identified in the spun-off company's balance sheet at the time of the spin-off, the divided company's capital gains earned from the spin-off can be determined based on the value of the identified MV.

5. Explain why companies pursue spin-offs, even when tax savings are not anticipated in the spin-off under the current tax law.

Both tax and non-tax costs must be considered to establish effective tax planning, as indicated by Scholes et al. (2008). It is anticipated that non-tax costs were considered more in the planning and execution of the Dongbu Group's four spin-offs than tax costs, given that there was no chance to save the taxes on capital gains incurred during the spin-offs. Non-tax costs may include operations, political, and financial costs, which seemed to be the Dongbu Group's primary concern.

The Journal of Small Business Innovation 2017 20(1), pp. 1-18

세무계획측면에서 분석한 동부그룹 물적분할

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본 연구는 물적분할에 대한 법인세 과세제도가 개정된 2010년 7월을 전후해서 다수의 물적분할을 진행한 동부그룹의 구체적인 사례를 바탕으로 모든 거래당사자들의 관점에서 물적분할의 당사자인 분할법인과 분할신설법인의 법인세 부담이 최소화되도록 물적 분할의 유형을 선택하는 거래를 구성했는지에 대하여 분석하였다.

2010년 6월 이전에 적용된 제1기 과세제도에서는 과세이연요건을 만족하는 적격물적 분할의 경우에 분할법인의 자산양도차익에 대한 과세이연을 통해 비적격물적분할에 비해 법인세 부담이 작아지는 것을 확인할 수 있다. 이에 반해 2010년 7월 이후부터 2011년 말까지 적용된 제2기 과세제도에서는 적격물적분할의 경우에 양도차익에 대해 분할법인과 분할신설법인에게 각각 장래의 주식처분시점과 자산의 처분 및 상각시점에서 과세함으로써 현재가치를 고려하면 비적격물적분할에 비해 상대적으로 세금부담이 커질 수도 있다.

본 연구에서 분석한 동부그룹의 4건의 분할 사례 중에서 1건((주)동부한농 사례)은 제1기 과세제도에서 이루어진 것이고, 3건((주)동부케미칼, (주)동부익스프레스 및 동부특수강(주) 사례)은 제2기 과세제도에서 이루어진 것인데, 조세비용의 측면에서 분석하면 (주)동부한농 분할사례는 적격분할일 것으로 예상되고, 나머지 3건의 분할사례는 구체적인 할인율 및 처분기간 등을 적용하면 비적격분할일 것으로 예상된다.

그러나, 해당 기업들의 합병 관련 공시 내용을 분석하면 이들 분할사례에서는 양도차익이 발생하지 않아서 분할방식의 선택을 통한 절세효과를 얻을 수 없었던 것을 확인할 수 있다. 이와 같이 조세비용의 측면에서는 전혀 유인이 없는 상황에서 동부그룹이 단기간에 4건의 물적분할을 한 것은 조세비용에 비해 비조세비용이 분할의사결정에 더욱 중요했던 것으로 추정할 수 있다. 즉, 이들 물적분할에 대하여 실무계에서는 악화된 그룹의 재무구조를 개선하기 위한 것이라는 분석이 제기되었고, 실제로 물적분할을 통해 취득한 분할신설법인의 주식을 단기간에 매각한 사실도 확인할 수 있으므로 이러한 추론이 타당하다고 할 수 있을 것이다.

따라서, 본 연구의 분석을 통해 물적분할의 과정에서 분할법인과 분할신설법인의 세금부담을 동시에 고려하는 모든 거래당사자들(all parties)의 관점과 함께 조세비용과 비조세비용을 동시에 고려하는 모든 비용(all costs)의 관점도 중요하게 고려되어야 한다는 점을 확인할 수 있다. 또한, 이들은 효과적인 세무계획(effective tax planning)을 수립하기 위해 반드시 고려해야 하는 관점들이기 때문에 기업들이 중요한 의사결정에서 효과적인 세무계획을 실행하기 위해 다양한 측면에서 사전적으로 검토하는 사실도 간접적으로 확인할 수 있다.

주제어 : 물적분할, 과세이연조건, 효과적인 세무계획

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