Dividend Distribution under the Korean Commercial Code

I. Overview of Dividend Payment under the Korean Commercial

"Dividend distribution" means a company's payment of profits that it earned from business activities to its shareholders under the Korean Commercial Code (the "KCC") and is important to shareholders in terms of return on investment as well as to the company itself in terms of business policy. The KCC classifies dividends paid by a joint-stock company into regular dividends and interim dividends depending on when such dividends are paid.[1] Regular dividends are paid once a year by a resolution of the ordinary general meeting of shareholders ("GMS") (or the board of directors, "BOD") (Article 462 of the KCC). On the other hand, interim dividends may be paid by a company that settles accounts once a year in the event its articles of incorporation ("AOI") provides that it may pay dividends to those who are shareholders on a reference date which falls within the period of account settlement and selected by a resolution of the BOD (Article 462-3 of the KCC).

II. Dividend Distribution Process

In general, payment of cash dividends is subject to the following process:[2]

(1) Prior review and preparation

- Before deciding whether to pay dividends, a company confirms its net income and voluntary reserves for the current year, reviews whether there are any distributable profits, and determines the amount of dividends to be paid (for more information on the calculation of distributable profits, please refer to Section III).

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1. The Financial Investment Services and Capital Markets Act (the "FSCMA") provides for an exception for listed companies to pay dividends on a quarterly basis to its shareholders as of the end of three, six, and nine months from the first day of the fiscal year in accordance with its AOI.
2. Under the KCC, dividends can be paid not only in cash but also in stock or in-kind. Dividends in stock and dividends in-kind are the same as regular dividends in the sense that they are funded by distributable profits. The only difference is the type of assets that shareholders receive as dividends.
3. Regarding dividends of listed companies, it was pointed out that the previous practice that the shareholders listed in the shareholders registry as of the end of the fiscal year are determined to be eligible to receive dividends is not consistent with the global standards. Thus, the Ministry of Justice stated in its administrative interpretation of Article 354 of KCC in January 2023 that a company may set a reference date for dividends to be a date after the date of the GMS by separating the reference date for voting rights and the reference date for dividends. In other words, a company may determine the amount of dividends at the GMS in March, decide which shareholders are eligible for dividends in early April, and then pay dividends.

(2) Decision on shareholders eligible to receive dividends[3]

- To determine which shareholders are eligible to receive dividends, a company sets a reference date and publically announces it in newspapers or on its website in accordance with the method of public announcement set forth in the AOI two weeks prior to the reference date. However, a company whose reference date is specified in the AOI (generally, providing that the shareholders listed in the shareholders registry as of the end of the fiscal year are eligible for dividends) may skip public announcement (Article 354(4) of the KCC).

(3) Approval of the BOD/GMS

- In principle, a company pays regular dividends once the GMS approves the statement of appropriation of retained earnings that was approved by the BOD. However, if its AOI provides that the BOD shall approve the financial statements for a fiscal year, it may pay regular dividends by a resolution of the BOD (Articles 462(2) and 449-2 of the KCC).
- If a company settles accounts once a year and its AOI provides that it may pay dividends within such year to those who are shareholders on a reference date selected by a resolution of the BOD, the company is allowed to pay interim dividends. When the basis for interim dividends is provided for in the AOI, the BOD may resolve to pay dividends in accordance with the AOI (Article 462-3 of the KCC).

(4) Dividend payment

- A company is required to pay dividends within one (1) month from the resolution of regular dividend by the GMS/BOD or the resolution of interim dividend (Article 464-2 of the KCC). However, if a company's GMS or BOD determines the dividend payment date otherwise, the company shall pay dividends on such date.

III. Calculation of Distributable Profits

1. Overview

Hefty dividends may cause corporate assets to be taken out of the company excessively and therefore undermine its creditors' interests and violate the principle of capital adequacy. In order to protect creditors, the KCC limits profit distribution by a joint stock company utilizing surplus (through dividend distribution or purchase of treasury stock) to its distributable profits.

2. Calculation of Distributable Profits

(1) Regular Dividends

Distributable profits that may be paid as regular dividends are calculated by deducting the following items from the net assets on the balance sheet: (i) the amount of capital; (ii) the total amount of capital reserve and earned surplus reserve accumulated within the applicable fiscal year; (iii) the amount of earned surplus reserves to be accumulated in the fiscal year; and (iv) unrealized profits (gains from valuation of assets or liabilities) prescribed by the Presidential Decree (Article 462(1) of the KCC). The amounts stated in items (i), (ii) and (iii) are deducted from distributable profits in order to reserve them to the company as the debtor's liability property. Deduction of item (iv), i.e., unrealized profits, was introduced in the amendment to the KCC in 2011. Since the International Financial Reporting Standards ("IFRS") was introduced, corporate assets are no longer valued at the acquisition cost but at fair value, and this means that, under the new standards, unrealized valuation gains recorded on a company's books may be included in distributable profits although they have not been realized. If such unrealized gains are included in the distributable profits, this may result in excessive dividends and reduction of the company's net assets. Deduction of item (iv) seems to have been introduced to prevent this risk.

(2) Interim Dividends

The fund source to pay interim dividends from are different from distributable profits within which regular dividends are paid in the sense that interim dividends are distributed during a fiscal year. The amount that may be utilized for interim dividends are calculated by deducting the following items from the net assets on the balance sheet of the immediately preceding fiscal year: (i) the amount of capital in the immediately preceding fiscal year; (ii) the total amount of capital reserve and earned surplus reserve accumulated in the immediately preceding fiscal year; (iii) the amount determined to be distributed or paid as profit at the ordinary GMS in the immediately preceding fiscal year; and (iv) the amount of the earned surplus reserve to be accumulated in the fiscal year during which interim dividend is paid (Article 462-3(1) of the KCC). Unlike the calculation of the distributable profits within which regular dividends are paid, the unrealized profits prescribed by Presidential Decree are not deducted.

As such, the limit on interim dividends is based on the distributable profits as of the end of the immediately preceding fiscal year, and thus does not reflect the situation of the current fiscal year. If there is a risk that a company's net assets on the balance sheet of the current fiscal year would fall short of the sum of items (i) through (iv) above, which are used to calculate distributable profits for regular dividends, the company shall not pay interim dividends. If a company has paid interim dividends while its net assets on the balance sheet of the current fiscal year fall short of the sum of the above amounts, the directors shall jointly and severally compensate the company for the difference (or the dividend amount, if the dividend is less than the difference), unless the directors prove that they have not breached duty of care in determining that there was no such risk (Article 462-3(3) and (4) of the KCC).

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