Korea Tax Updates

Supreme Court's Final Decision on Lone Star Case – First and Second Trial Verdict Overturned in Favor of the Republic of Korea

On April 24, 2025, the Supreme Court ruled in favor of the Republic of Korea after 8 years of litigation.

Background

An intermediate holding company of Lone Star received dividends throughout 2004 and 2007 from its investments in Korea. Upon the dividend payment, the withholding tax agents (i.e., companies that distributed dividends) withheld corporate income tax of approximately KRW 160 billion in aggregate at source. In 2008, the National Tax Service (NTS) imposed corporate income tax of approximately KRW 170 billion on the basis that the beneficial owner of the dividend is not the intermediate holding company but the upper-level investors and determined that those investors had a permanent establishment (PE) in Korea. Since withholding tax on such dividend (amounting to KRW 160 billion) was prepaid, the NTS deducted the tax previously withheld from the total assessment of KRW 170 billion and Lone Star was subject to tax payment only on the remainder.

In 2017, the Supreme Court ruled that the upper-level investors should not be deemed to have a PE in Korea and thus cancelled the KRW 170 billion tax assessment. However, the NTS only refunded approximately KRW 20 billion, excluding the portion of tax withheld at source on the grounds that only the withholding tax agents have the right to request for a refund on the KRW 160 billion withheld at source. Consequently, persons liable to tax (hereinafter referred to as the "taxpayer") filed a civil lawsuit against the Republic of Korea, claiming that they had the right to claim for return of the unjust gain of KRW 160 billion appropriated by the Korean government (by this time, the time period to claim a tax refund lapsed and thus a civil lawsuit had to be pursued).

Issue

The issue is who has the right to claim the prepaid withholding tax that offset the total tax assessment amount upon finding a PE if such assessment was subsequently cancelled. Specifically, the question is whether the prior withholding obligation of the withholding tax agent automatically expires upon cancellation of an assessment and thus the taxpayer (in this case Lone Star and other taxpayers) has the direct right to request a refund on taxes withhold at source although there was no formal transfer of the right to request a refund from the withholding tax agent to the taxpayer.

Court Ruling

The Supreme Court's ruling clarified that if the taxpayer has not received the right to claim a refund of withholding tax from the withholding tax agent, the right to claim refund for tax withheld at source remains with the withholding tax agent.

VAT Monthly Transaction Reporting Obligation Expanded to Foreign Online Platform Service Providers and Payment Gateway Service Providers

The VAT Law (VATL) Article 75 requires certain value-added telecommunications service provider that provides online marketplace platform service, a payment gateway service provider, a digital financial service provider or a specialized foreign exchange dealer (i.e., digital intermediary service providers) to submit monthly transaction details (e.g., information regarding the underlying transaction party, number of transactions, transaction amount, etc.) to the Korean tax authority by 15th of the month following the end of each calendar quarter. The purpose of this requirement is to collect transaction data from intermediary service providers to verify the sales data of the underlying suppliers.

Prior to the recent update in March 2025, it was unclear whether foreign digital intermediary service providers were subject to the monthly reporting requirements, but effective July 1, 2025, VATL Article 75 specifies that foreign residents and corporations that provide intermediary services stated above would be subject to the reporting requirements. The amendment to this article also clarifies that the scope of transactions to be captured in the monthly reporting excludes supply of goods or services from foreign suppliers through the digital intermediary service providers. If the taxpayer does not comply with submission of information, a fine of up to KRW 20 million will be imposed.

Newly Issued Tax Interpretations

Whether the 95% foreign source dividend exclusion rule can apply to dividends from a foreign subsidiary subject to CFC rules when there are no undistributed earnings deemed to be paid by application of the CFC rules because all distributable earnings were distributed at end of year

Under the CFC rules, a Korean resident is deemed to have received dividend from its foreign subsidiary's undistributed earnings as of the end of the year if (i) the Korean resident owns directly or indirectly at least 10% in number or value of the subsidiary's shares (tested at the subsidiary's year-end) and (ii) the average effective tax rate in the foreign subsidiary's jurisdiction during the most recent 3 years is 70% or less of the top marginal corporate income tax rate in Korea.

On December 31, 2022, the Korean tax law added a new tax provision excluding 95% of dividend distributed by a foreign subsidiary from taxable income of a Korean corporation which holds directly at least 10% in vote or value of the subsidiary's shares (95% dividend exclusion rule). The provision also states that a foreign subsidiary subject to CFC rules would not be eligible to apply the 95% dividend exclusion rule on deemed dividends and upon actual pay out of such deemed dividends.

A recent tax ruling (Seomyun-2024-Bubgyugookjo-3981) clarified that although a Korean corporation does not recognize any deemed dividend by application of the CFC rules because the foreign subsidiary has actually paid all undistributed earnings to the Korean corporation as of each year-end, such dividend does not qualify for the 95% dividend exclusion rule.

Keynote: If a foreign subsidiary of a Korean corporation is subject to the CFC rules, any deemed or actual dividend the Korean corporation recognizes from such foreign subsidiary does not qualify for the 95% dividend exclusion rule.

Clarification on what constitutes a certificate of residency

Tax ruling Seomyun-2025-Gookjesewon-0604 clarifies that a certificate of residency that is required to be attached to a tax exemption application refers to a form officially issued by a competent authority in the jurisdiction which has entered a tax treaty with Korea and validates that the applicant is a resident of such jurisdiction for tax purpose.

Keynote: The tax ruling has clarified that any document that does not confirm the tax residency of a taxpayer is not regarded as a certificate of residency.

Determining withholding tax obligation of buyer that acquires Korean company shares from a foreign partnership

Tax ruling Seomyun-2024-Gookjesewon-3147 provides guidance that in case a buyer acquires Korean company shares from a foreign partnership which is a flow-through entity*[1], any income derived from the share transfer is directly attributed to the partners of the foreign partnership. Therefore, the buyer is required to withhold the relevant tax on such income attributable to the partners in accordance with the withholding tax provisions. Specifically, if one of the partners of the foreign partnership is a Korean resident or a domestic corporation, the recipient of any Korean source income from the share transfer will be deemed to be the Korean resident or domestic corporation, not the foreign partnership.

Keynote: The tax ruling indicates that in accordance with the general withholding tax provisions, a buyer of Korean company shares is not required to withhold tax on Korean source capital gain derived from transfer of Korean company shares and attributable to a partner of a foreign partnership that is a Korean resident or a domestic corporation.

Determining the income classification of Korean source income derived by a Japanese entity from participating in a profit-sharing scheme in return for bearing game development costs of its Korean parent company

Tax ruling Seomyun-2024-Bubgyugookjo-3613 explained that if a Korean corporation, a game developer or publisher, receives investment in game
development costs from its Japanese subsidiary without an obligation to return the principal and agrees to share a certain percentage of the game's sales in the future with the subsidiary, whether such Korean source revenue is classified as dividend under the Korea-Japan Tax Treaty Article 10, Paragraph 3 should be determined by comprehensively examining the nature of the arrangement including the extent of investment risk borne by the Japanese subsidiary, the extent of the Japanese subsidiary's participation in the profit sharing scheme and whether the investment principal is actually returned to the subsidiary.

Keynote: Income classification of Korean source income under a relevant tax treaty may not be straight forward in certain cases and thus, the income classification could differ

[1] Income is not attributed to the entity itself but is directly attributable to each individual partner (e.g., a Cayman Islands exempted limited partnership which does not have a legal personality and is established as an overseas investment vehicle that raises funds through investment offering, manages investment assets, derives value from the acquisition and disposition of such assets, and distributes such derived value to its investors)

from the perspective of two different jurisdictions. In such case, there is a risk that withholding tax paid in the income paying jurisdiction does not qualify for relief from double taxation in the income receiving jurisdiction which views the income classification differently. If such uncertainty exists, a taxpayer may need to seek clarification from the competent authorities to avoid double taxation on the same source of income.

Clarification on the obligation to submit Country-by-Country Report (CbCR)

If a ultimate Korean parent company of a multinational group with prior year sales exceeding KRW 1 trillion on a consolidated basis discontinues to prepare consolidated financial statements for financial reporting purposes in accordance with the relevant accounting principles, the ultimate Korean parent company is no longer obligated to submit CbCR to the Korean tax authority under Article 16(1) and (2) of the Law for Coordination of International Tax Affairs (Seomyun-2024-Bubgyugookjo-0247).

Tax Tribunal's clarification that certain benefit recognized by a foreign corporation upon acquiring shares of a domestic corporation at a price below the arm's length value from an overseas related party should not be regarded as "donation of assets located in Korea" and thus taxed as Korean source other income to the foreign corporation

The Tax Tribunal explained that unlike the Inheritance and Gift Tax Law (IGTL), the Corporate Income Tax Law (CITL) does not specify the term "donation" to include economic benefits from transfer of shares below an arm's length price (or refer to the definition of donation under the IGTL), and hence the term donation should be interpreted generally in accordance with the Civil Code (i.e., transfer of assets free of charge). In other words, it is incorrect to classify a deemed economic benefit from acquiring domestic corporation shares at a price below the arm's length value as a donation and assess tax on such donation (Tax Tribunal case 2024Joong2296 decided on March 11, 2025; similar case 2022Joong2748 decided on October 31, 2024).

Keynote: The tax tribunal interpretation above indicates that a foreign corporation's deemed economic benefit from acquiring a domestic corporation's shares below an arm's length price should not be reclassified as a donation (i.e., Korean source other income) but should retain its income character as capital gains from transfer of domestic corporation shares.

Supreme Court's decision to re-characterize a transaction by application of the substance over form principle

The substance-over-form principle incorporated in the Korean tax law stipulates that a party is deemed to have unjustly obtained tax benefits by means of indirect methods involving third parties or through multiple acts or transactions, such acts or transactions shall be recharacterized based on the economic substance, either as a direct transaction between the parties or as a single, continuous act or transaction.

Supreme Court case 2023Du378565 (decided on March 27, 2025) applied the substance-over-form principle to recharacterize a real estate agency business as a land sales business which resulted in the plaintiff (taxpayer) under-reporting corporate income tax and being subject to penalty for issuing false tax invoices.

The plaintiff contracted with 3rd parties to provide real estate purchase and sales agency services. However, the Supreme Court determined that the underlying intent of the plaintiff was to directly purchase and sell agricultural land instead of acting as an agent based on several facts. First, the 3rd parties purchased the land using funds loaned by the plaintiff. Also, the sales proceeds received from sale of such land were collected by the plaintiff first and transferred to the 3rd parties after the plaintiff subtracted a sales commission amounting to 65% of the land sales price. On the other hand, the profit gained by 3rd parties upon selling the land was only 6% of the resale profit. Finally, the Supreme Court did not find justification for the plaintiff to engage in the transaction as an agent other than for tax avoidance purpose and concluded that the plaintiff could have purchased and sell the land directly. Consequently, the Supreme Court re-characterized the transaction as a direct purchase and sale of land by the plaintiff.

Keynote: This case is noteworthy since the Supreme Court clarified that application of the substance-over-form principle is not limited to cases involving sham transactions that lack legal effect. It also applies to acts of tax avoidance which employs an unreasonable form or appearance that is inconsistent with the substance of the transaction although the act does not rise to the level of a sham. Moreover, if an act or a transaction is found to have originated from an unlawful purpose in violation of mandatory provisions or public order, although a taxpayer demonstrates a business necessity for adopting a certain form or structure, it is unreasonable to deny the existence of a tax avoidance purpose. Accordingly, business rationale alone should not be readily accepted as sufficient to argue against a taxpayer's tax avoidance motive.

Upcoming Tax Reporting Reminder

• Country-by-Country Report Notification due by June 30, 2025 for calendar year taxpayers (due within 6 months from end of business year)

• VAT Monthly Transaction Reporting Obligation for foreign online platform service providers and payment gateway service providers due by July 15, 2025

• Report of Overseas Financial Accounts due by June 30, 2025 for residents or domestic corporations holding an overseas financial account and the aggregate account balance exceeds KRW 500 million for ay last day of a month during 2024

International Tax Team – Key Contacts

Oh, Sang Bum	sangbumoh@kr.kpmg.com	02-2112-0721
Lee, Sung Wook	sungwooklee@kr.kpmg.com	02-2112-0946
Cho, Sang Hyun	sanghyuncho@kr.kpmg.com	02-2112-7687
Suh, Yu Jin	yujinsuh@kr.kpmg.com	02-2112-0930
Song, Hyung Woo	hyungwoosong@kr.kpmg.com	02-2112-0275
Min, Woo Kee	wmin@kr.kpmg.com	02-2112-6886
Kang, Sung Won	kang22@kr.kpmg.com	02-2112-6771
Ryu, Su-Seok	suseokryu@kr.kpmg.com	02-2112-6787